



CUSTOMS POST CLEARANCE AUDIT STRATEGY

REPORT

FINAL

Monday, July 18, 2011

This publication was produced for review by the United States Agency for International Development. It was prepared by Deloitte Consulting LLP.

CUSTOMS POST CLEARANCE AUDIT STRATEGY

REPORT

FINAL

USAID ECONOMIC PROSPERITY INITIATIVE (EPI)

CONTRACT NUMBER: AID-114-C-10-00004

DELOITTE CONSULTING LLP

USAID/CAUCASUS

MONDAY, JULY 18, 2011

DISCLAIMER:

The author's views expressed in this publication do not necessarily reflect the views of the United States Agency for International Development or the United States Government.

DATA

Author(s): Bert Cunningham

Name of Component: Business Enabling Environment

Practice Area: Customs

Key Words: Post-clearance customs audit, Revenue Service, action plan

Reviewed by: Bondo Bolkvadze and Nato Beruashvili

ABSTRACT

Compliance verification through post-clearance audit (PCA) is a basic instrument of customs control to balance gaps and potential risks caused by any procedural simplification in customs. In developed customs administrations, the major function of control is done by PCA. Risk management plays a significant role in its effective implementation.

Georgian Customs PCA is currently at a very basic level. However, Georgia's Customs Administration has implemented significant trade facilitation measures, which have led to simplification of customs procedures. However, simplification revealed drastic need for alternative mechanisms of control. This report examines international best practice PCA and provides recommendations for the implementation of risk-based PCA controls that will serve as an integral part of Georgian Customs' reform and modernization program.

ABBREVIATIONS

ASYCUDA	Automated System for Customs Data
BPR	Business Process Review
EU	European Union
FIU	Ministry of Finance’s Financial Investigations Unit
HR	Human Resources
IFC	International Finance Corporation
IMF	International Monetary Fund
IT	Information Technology
KPI	Key Performance Indicators
NTTFC	National Trade and Transport Facilitation Committee
MoF	Ministry of Finance
PCA	Post-Clearance Audit
PCO	Project Control Office
RKC	Revised Kyoto Convention on the Simplification and Harmonization of Customs Procedures
RS	Georgian Revenue Service
SOP	Standard Operating Procedure Manual
UNCTAD	United Nations Conference on Trade and Development
USAID	United States Agency for International Development
WB	World Bank
WCO	World Customs Organization
WTO	World Trade Organization

CONTENTS

I.	EXECUTIVE SUMMARY	1
II.	APPENDICES	4
	A. BACKGROUND	5
	B. FINDINGS & RECOMMENDATIONS.....	17
	C. ADDITIONAL INFORMATION.....	76

I. EXECUTIVE SUMMARY

Implementation of risk-based post-clearance audit (PCA) controls should be an integral part of Georgian Customs' reform and modernization program. Its implementation will allow the Georgian Revenue Service (RS) to obtain a more appropriate balance between its on-going trade facilitation agenda and the need to strengthen its customs controls. Implementation will support Georgian Customs as it continues to expedite the release of goods in an effort to encourage an attractive foreign investment climate. It will afford an opportunity to keep cargo dwell times and related trade transaction costs to an absolute minimum, while also allowing Georgian Customs to more effectively tackle commercial fraud, especially under-valuation of imports and associated revenue losses.

Compliance verification through PCA is a prerequisite to implementing an Authorized Economic Operator (AEO) regime. AEO regimes will strengthen the international supply chain and rewarding those firms that meet the strict security requirements confirmed through AEO security audits. Firms granted AEO status by Georgian Customs will receive expedited clearance of their exports as they enter those foreign markets that mutually recognize the AEO status granted by Georgian Customs.

Implementation of an effective PCA program in Georgia will require a significant investment in both material and human resources. The RS will need to:

- Display significant commitment and ownership to implement risk-based PCA's;
- Strengthen the current legal framework so it fully supports PCA's;
- Draft Standard Operating Procedure (SOP) manuals for both risk management and PCA;
- Redress significant weaknesses in human resource management and development in both the Risk Management and Post-Clearance Audit Divisions, including:
 - Bringing the organizational structure for the Risk Management Division and Customs Post-Clearance Audit Division in-line with international best practice;
 - Giving customs intern auditors additional foundational technical customs training courses especially in customs valuation, H.S. classification, and origin/preferential trade agreements. It is important that intern auditors have a comprehensive understanding of these key areas before they receive specialized technical training courses in post-clearance auditing techniques;
 - Providing all staff posted to the Post-Clearance Audit Division with additional ASYCUDA technical user training and a password to allow them access to the ASYCUDA database. This would allow PCA staff to efficiently and effectively retrieve declaration data and produce statistical reports, in order to analyze and select high-risk traders and particular high risk transactions to audit;
 - Giving PCA staff direct access to the current customs valuation reference price database so they may compare declared customs import values of goods with those values/reference prices maintained in the database;

- Developing a tariff classification rulings database and making it available to PCA's (as well as Gezi staff) such that H.S. explanatory notes and all international and national tariff classification rulings be available on-line to staff (and also stakeholders);
- Increasing the number of auditors in the Customs Post-Clearance Audit Division by adding 15 additional auditors to supplement the existing staff of 10, then a second intake of 25 customs interns after the first group of 25 post-clearance auditors have gained experience and proven their ability to efficiently and effectively conduct both desk audits and field audits. The second batch of interns would be needed approximately 6 months after the first group have received their PCA training and had an opportunity to apply the new desk audit and field audit techniques. At this time, some of these auditors could be redeployed to the various regional offices;
- Providing additional office space and IT equipment in the short term at HQ for these additional auditors i.e. until both batches of auditors (i.e. 50 in total) have received training and gained practical experience in undertaking desk and field audits and are ready to be relocated back to the regions. In the medium term, office space and IT equipment should be provided in the regional offices for post-clearance auditors;
- Providing a classroom at RS HQ for two sessions of 25 auditors, for delivery of foundation customs technical training, followed by risk management and post-clearance desk and field audit training;
- Assigning two (2) experienced, full time, dedicated Georgian trainers to receive training from EPI experts. Once trained, these trainers would then deliver the customs foundation training courses in valuation, tariff classification and origin, then the specialized training courses in risk management and PCA techniques in Georgian;
- Drafting job descriptions for managers and officers working in both the Risk Management Division and the Post-Clearance Audit Division;
- Reviewing auditor basic remuneration and bonus system, then improving the basic remuneration and implementing a performance-based incentive scheme for auditors. RS needs to ensure that customs post-clearance auditors receive an adequate salary comparable to what they would earn in the private sector as an auditor. Consideration should also be given to introducing performance based bonuses or other motivational incentives for auditors. In some customs services, these incentives may be related to additional revenue assessed/collected from the conduct of an audit;
- Designing and implementing an anti-corruption strategy for post-clearance auditors; and
- Providing laptops to those auditors performing field audits;
- Provide vehicles or vehicle allowances for field auditors visiting traders' premises;
- Prepare tender/procure Risk Management Software Suite to support risk management and PCA's;
- Strengthen the risk management channeling in ASYCUDA, bringing it more in line with international best practice;

- Encourage more traders to e-file their declarations by increasing fees charged for this data entry function and offering Direct Trader Input terminals at checkpoints and Gezi's. Specific objectives should be set to reduce data keying by Customs over the next 18 months e.g. 75% of total import declarations e-filed by end of 2012, 95% e-filed by end of 2013;
- Extend the World Customs Organization (WCO) CEN database to Risk Management Division and Post-Clearance Audit Division;
- Prepare a realistic annual audit plan, which is critical to the success of the PCA program. The annual audit plan will ensure optimum use of limited audit resources i.e. ensure resources are allocated on the basis of risk to achieve maximum results (estimated short term technical assistance is 1 month);
- Examine and, if necessary, amend its current mutual administrative assistance agreements to ensure they fully support PCA requirements;
- Implement international best practices for risk management to develop risk profiles and selectivity criteria; and
- Implement international best practices for conducting post-clearance desk, field and IT based audits.

This report provides an in-depth strategy for RS Customs to implement an efficient and effective risk-based PCA control program, and offers estimates for external technical assistance to support implementation.

II. APPENDICES

A. BACKGROUND

B. FINDINGS & RECOMMENDATIONS

C. ADDITIONAL INFORMATION

A. BACKGROUND

INTERNATIONAL BEST PRINCIPLES AND PRACTICES FOR A MODERN CUSTOMS ADMINISTRATION

The World Customs Organization's (WCO) Revised Kyoto Convention on the Harmonization and Simplification of Customs Procedures and the World Trade Organization recommends the following comprehensive list of best principles and practices that modern customs administrations should follow:

- Shift from exclusive use of transaction by transaction movement-based controls, to more PCA-based controls;
- Apply risk management techniques in all customs controls;
- Implement Authorized Economic Operator (AEO) programs to secure the international supply chain and facilitate the movement of cargo of known and compliant operators;
- Implement compliance performance measurements to keep customs control programs effective and efficient;
- Promote customs/trade co-operation in order to keep stakeholders aware of changes in trade practices and encourage their voluntary compliance with customs laws;
- Sign mutual administrative assistance agreements with stakeholders and other customs services to better cope with the globalization of trade and related commercial fraud; and
- Ensure customs staff are sufficiently trained, motivated and operate under sound legislation, organization and procedures.

The World Trade Organization (WTO) Doha Development Round is currently negotiating a trade facilitation agreement, which includes many key measures that are specifically designed to expedite the clearance and release of goods at the borders through implementation of:

- PCA controls;
- Risk management;
- Pre-arrival clearance;
- Separation of release from clearance of goods; and
- Authorized trader schemes.

Georgia is a member of the WCO. Though no formal and comprehensive customs reform and modernization program currently exists, RS management has confirmed that Georgia intends to accede to the WCO's Revised Kyoto Convention and the Framework of Standards. To do so will require that Georgian Customs apply all of the reforms listed previously. As a contracting party to the WTO, Georgia will be bound to implement any trade facilitation measures ultimately negotiated at the Doha Round Negotiations. Therefore, both

the WCO and WTO require that Georgia will be obliged to implement PCA controls and strengthen its risk management.

Recent diagnostic reports of Georgia's Customs administration prepared by the EU, World Bank and USAID/EPI Project have critically assessed the various weaknesses of Georgian Customs as it is currently operating within the context of the Georgian Revenue Service (RS). Serious deficiencies in both customs PCA and risk management have been highlighted in all of these previous diagnostic reports of Georgian Customs.

This report does not revisit the many observations and recommendations made in these earlier reports regarding the need for the RS to create an enabling environment necessary to allow a comprehensive customs reform and modernization program to proceed and remain sustainable. It is presumed that the RS will ensure that an enabling environment will be created in the short-term. This report focuses solely on the specific task of developing a strategy to implement risk-based customs PCA controls based on internationally recommended best practices.

It must be emphasized, however that the implementation of risk-based customs PCA controls cannot be designed or implemented in isolation of other supporting customs modernization and reforms, including:

- Modernizing the customs legal framework
 - It is important to ensure that the existing tax code and bylaws fully support operation of PCA's. Further work will be necessary to analyze specific deficiencies and to draft legislative amendment where needed to support implementation of PCA's.
- Writing a Standard Operating Procedures (SOP) manual
 - There is currently no SOP manual to support customs administration. An SOP manual will need to be written to clearly describe post-clearance desk and field audits. A supporting SOP manual will also need to be written in regards to risk management related to PCA control. These two SOP manuals will need to be written in a structure, at a level of detail and using terminology that should be consistent with other SOP manuals prepared to support other customs reforms.
- Redressing human resource development and management issues related to PCA.
 - The Post-Clearance Audit Division (and the Risk Management Division) needs to be correctly positioned within the RS organization structure. It will also be important to prepare job descriptions for PCA management, auditors and support staff. It will be important to ensure there is an adequate number of qualified and trained customs staff deployed to the Post-Clearance Audit Division to handle the planned workload. Staff need to be properly remunerated and incentives created. They will need to be provided with the necessary technical customs training and skills to undertake desk audits and field audits in an efficient and effective manner. Auditors will need laptops, vehicles for conducting field audits, and administrative support. An anti-corruption strategy and strengthened code of ethics needs to be put in place to ensure that customs auditors operate at the highest levels of integrity.
- Ensuring that risk management processes support the audit function

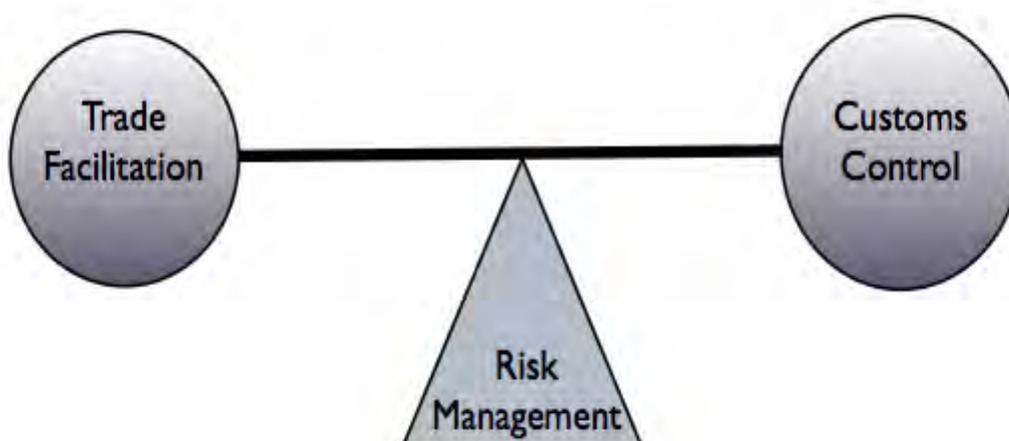
- It must be emphasized that the efficiency and effectiveness of customs PCA's to a large degree depends to a large degree on the risk management processes operated at each stage of customs controls – whether these controls operate on a pre-release or post-release basis. It will be necessary to improve the pre-release risk channeling of customs declarations, including any risk channeling that sends import declarations to the Post-Clearance Audit Division. Similarly, it will be vitally important to strengthen the risk management processes related to how high risk sectors and traders within each sector are selected for post-clearance desk audits and field audits. To put it another way, PCA controls must be designed taking into account what other customs controls and risk management techniques are being exercised by Georgian Customs from the time goods arrive in the country until the time the goods are released from customs control. PCA should not be viewed as a single customs control applied after release of goods. PCA is the final customs control, in a series of controls, which is applied by customs within a comprehensive customs control process. PCA control has a direct affect on how other controls are exercised by customs movement controls prior to release, and visa-versa. Similarly, risk management applied on customs movement controls prior to release must be integrated with and support risk management applied on PCA control. Risk management is central to operating both pre-release customs movement controls and PCA controls.
- Developing a risk-based national audit plan
 - Central to an effective risk management process for PCA will be the development of a national audit plan and development/maintenance of audit risk profiles. Risk management requires on-going intelligence and enforcement data from various sources including those units undertaking commercial fraud investigations. It is critically important that intelligence is received regularly from all sources within the RS (i.e. checkpoints, X-Ray scanning units, Gezi's Tax Audit Division, as well as from outside sources including stakeholders and the general public, the Fiscal Investigation Unit, the Police, other border agencies, and customs administrations in other countries. Mutual administrative assistance agreements will be important to encourage and facilitate the timely exchange of intelligence, investigation and audit related documents/information.

BALANCING TRADE FACILITATION AND CONTROL OBJECTIVES USING RISK MANAGEMENT AND PCA

In applying customs controls, all modern customs administrations must maintain an acceptable balance between the twin, and often time perceived to be competing, objectives of trade facilitation and control/enforcement. The use of risk management is the primary mechanism used by customs administrations to maintain an acceptable balance.

Risk management allows Customs to selectively target the small number of high-risk consignments requiring detailed documentary scrutiny and/or physical inspection, while leaving the vast majority of low risk consignments to move/be released by customs with a minimum intervention or inconvenience.

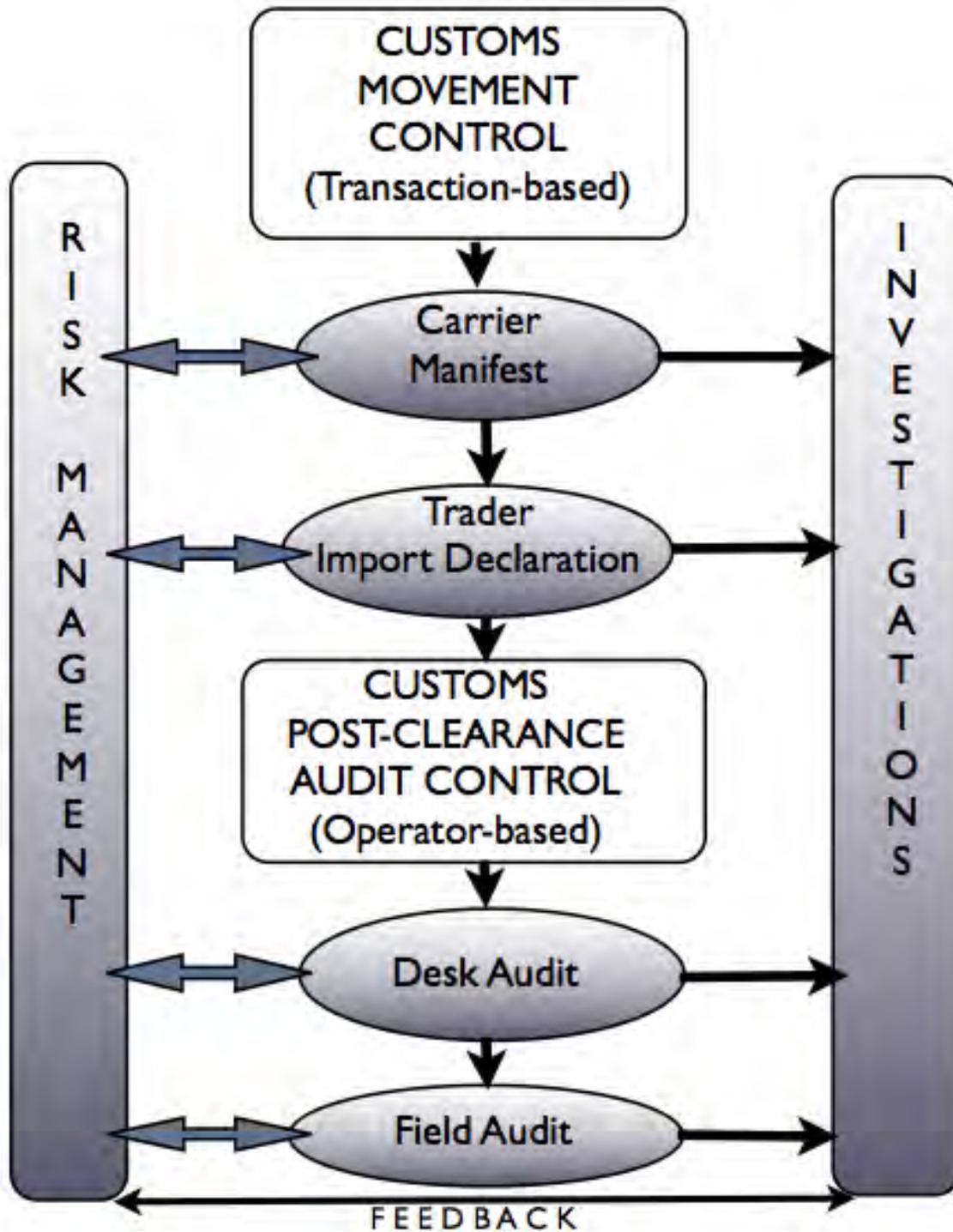
Risk Management is the only way for modern Customs administrations to achieve and maintain an appropriate balance between the competing objectives of facilitating trade while operating customs controls to enforce customs laws



Achieving and maintaining an appropriate balance between these two divergent objectives is not easy. Every customs administration around the world, including Georgian Customs, is struggling every day to maintain this balance.

Maintaining an acceptable balance requires putting in place and fully supporting a comprehensive risk management process. A properly staffed and specially trained Risk Management Division needs to be created for the entire RS, which constantly monitors and takes decisive corrective actions on a regular and timely basis. Risk management must be applied to all customs controls that exist throughout the entire clearance process, including customs movement controls which occur prior to release of goods, and PCA controls.

The following diagram illustrates the inter-relationship between pre-release movement controls, PCA controls and risk management.



The effective application of pre-clearance customs movement controls can have a significant positive effect on cargo dwell times and trade transaction costs.

It is important to emphasize that many customs controls can only be effectively and efficiently exercised prior to the clearance of the goods. For example, customs needs access to the goods in order to detect contraband such as drugs, weapons, illegal aliens; restricted or prohibited goods; counterfeit goods; excess goods/overages; concealed goods; etc.

Pre-clearance movement controls should be applied:

- At the time of the carrier's declaration (submission of carrier's cargo manifest);
- When the cargo actually arrives in the country; and
- At time that the trader's submits the import declaration for customs verification physical inspection of the goods, before release is granted.

PCA controls should be applied:

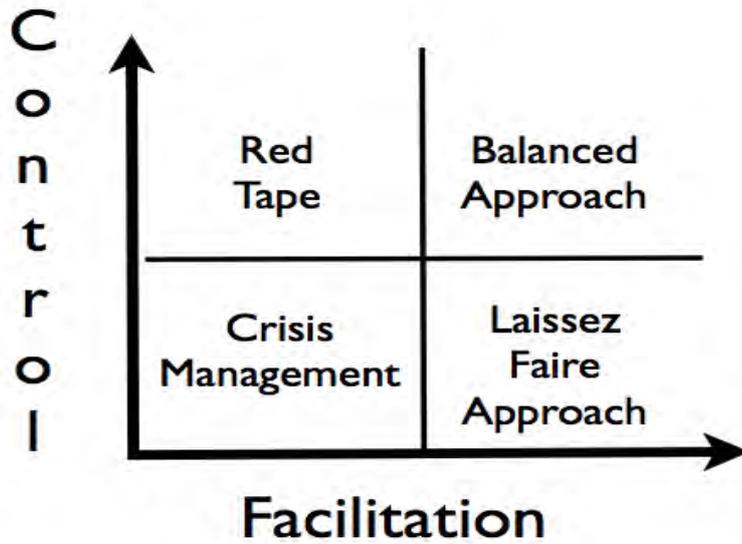
- When the goods do not necessarily have to be present in order to detect or determine whether certain other frauds have occurred. For example, customs valuation fraud is best detected by examining the books, records and financial accounts of a trader to determine the amount actually paid or payable for particular goods; and
- On authorized operators/traders who have already undergone a compliance audit and have been found to be keeping proper and auditable books, records and systems, and, through a pre-approval audit, to be in full compliance with customs laws. It is international best practice that customs administrations should only reduce or minimize pre-release movement controls applied on a trader/economic operator (i.e. reduced rates of documentary verification and/or physical cargo inspection), once that operator/trader has had its compliance verified through the conduct of a pre-approval audit of their books, records and systems. Risk management techniques need to be applied on a post-release basis to decide which high risk operators/traders and which of their trade transactions should be subjected to post-clearance desk and/or field audit.

Too much trade facilitation (i.e. not enough checking of cargo manifests and import declarations, or physical inspections of goods), may allow unscrupulous traders to:

- Avoid paying the correct amount of customs duty/tax; smuggle goods or other contraband that may be dangerous to society as a whole, or
- Create an un-level/unfair/non-competitive business environment which can injury domestic industry and discourage investment.

Too much customs movement-based control (i.e. red-tape, bureaucratic customs procedures and requirements, and too much checking of manifests and customs declarations and/or physical inspection of cargo) will cause significant cargo dwell times and high trade transaction costs that will discourage foreign trade, which is the engine for a country's economic development and growth.

The following graph illustrates the situations that arise when there is an imbalance between facilitation and control:



If Customs does not attempt to balance these objectives, customs management are continually in crisis mode, as they must deal with one crisis after another throughout the customs process. Too much customs control leads to complaints of red-tape, bureaucracy, cargo dwell times, discretionary practices and corruption.

If customs does not exercise adequate customs control, a “laissez faire” attitude pervades the customs administration and trade sector. All traders are facilitated, regardless of their risk. Over time, fraud and corruption becomes entrenched in the trade sector. Fraud, smuggling, revenue loss, and an un-level playing field cancel out the benefits of facilitated trade.

GEORGIAN CONTEXT

Within the RS Georgian Customs context, a serious imbalance currently exists between trade facilitation and control. Since the creation of the RS, trade facilitation has been the primary objective of the RS Customs. This trade facilitation objective has been driven from high political levels in the interest of creating an attractive business and investment climate. Customs control exercised throughout the customs process remain very weak. This has been caused by large staff retrenchment, which has not been followed up with significant training and capacity building for new recruits. Customs pre-clearance movement controls and PCA controls remain weak.

For example, the manifest module in ASYCUDA has never been implemented to provide RS Customs with a proper manifest control and acquittal system. Consequently, no automated risk management is currently applied on customs manifest data. Weak cargo controls prevent Georgian Customs from effectively ensuring that all goods arriving in Georgia are being declared to Customs, and those unclaimed goods are forfeited and auctioned by the State.

While the ASYCUDA system’s transit control module has been implemented, important control aspects are not operational and no automated risk management is applied. For example, contrary to international convention and best practice, no transit guarantees are required. There are no defined transit corridors and specific/realistic time limits set to

complete a transit movement. There is no mobile surveillance or tracking of transit movements and X-Ray scanners are not used to assist Customs in detecting goods that have been removed or substituted during a transit movement.

While the ASYCUDA system is capable of e-filing, the majority of import declarations are being manually prepared and data keyed by customs officers. Data entry using customs officers is contrary to international best practice and does not make efficient use of limited customs human resources that should be redeployed to more value-added control functions.

While the ASYCUDA system's selectivity module is in operation, it is limited to customs declarations. The selectivity module that controls which customs declarations are channeled for physical inspection (Red) or which are channeled for PCA (Blue) is not operating effectively. Because customs officers are preparing and keying customs declarations, RS management has decided that the ASYCUDA system does not need to identify high risk declarations requiring detailed documentary verification before release of the goods (presuming that the customs officer keying the data is able to do this task effectively). Instead, a quick, manual, and potentially discretionary monitoring of the quality of Green Channel declarations keyed by operators is performed by a supervising officer prior to the consignment being released. In effect, there is currently no risk-based selectivity requiring detailed documentary verification performed on customs declarations prior to the release of goods.

While ASYCUDA does select declarations to be sent to the Post-Clearance Audit Division, the risk management criteria utilized is not producing effective results. The customs Post-Clearance Audit Division, which recently moved from the Tbilisi Customs Clearance Office to the RS headquarters, is largely performing the highly selective transaction-by-transaction based import declaration verification that is still performed by the Monitoring Unit and Expertise Unit operating at the customs clearance offices.

While Georgian Customs has made significant progress to facilitate trade, there is now an urgent need to strengthen customs controls. This can be done without having any meaningful impact on the trade facilitation gains made.

The underlying principle of customs control is that controls should be kept to the minimum and should be carried out on a selective basis using risk management techniques to the greatest extent possible. Following this approach to customs control, a customs administration would be able to:

- Focus on high-risk areas and therefore ensure more effective use of available resources;
- Increase the ability to detect offenses and non-compliant traders; and
- Offer compliant traders greater facilitation and expedite trade.

While Georgian Customs has yet to recognize and act on the need to strengthen its customs movement controls, it has acknowledged the need to strengthen customs PCA control. While the expressed intent of strengthening customs PCA controls is laudable, it must be emphasized that the efficiency and effectiveness of any post-clearance control system is directly related to the effectiveness of pre-clearance movement controls exercised by Customs, and the effectiveness of the customs risk management process being applied throughout the entire customs process.

In an effort to bring these principles of customs to the attention of RS senior management, this report highlights the need to strengthen pre-clearance customs movement controls and customs risk management processes. Indeed, these actions should be considered prerequisites to introducing a customs PCA program.

It must be emphasized that in most countries, PCA control has been introduced for the express purpose of verifying the compliance of large, high volume traders before they are granted expedited release and other trade facilitation privileges. A compliance audit allows Customs to verify that the trader is audit-able, that is, keeping proper books, records and systems. It also allows customs to ensure that the trader is properly classifying and valuing its imports and has no previous history of non-compliance. Once compliance is verified, customs may reward the trader by granting certain privileges including:

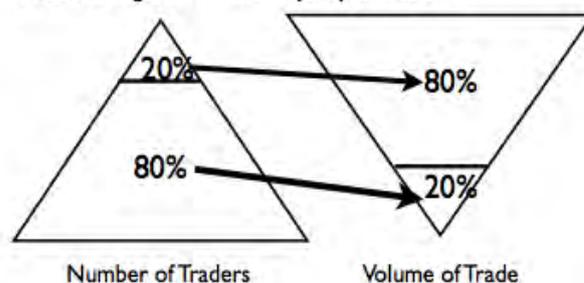
- Simplified and expedited clearance of goods;
- Significantly reduced rates of physical inspection;
- Consolidated customs declarations; and
- Periodic payment.

In the Georgian context, approximately 165 large importers have been granted „Gold List’ privileges. They are not subjected to pre-release movement controls. Their import declarations are not verified prior to the release of goods, and they rarely have their consignments subjected to cargo inspection (i.e. Gold List random inspection rates are set in the ASYCUDA system at or below 1%). While the principle of having a Gold List type system for large compliant traders is consistent with international best practices, the fact that none of these Gold List firms have yet to undergo any compliance audits either before being granted these privileges, or after they have been operating on the system for a number of years, must be viewed as a considerable risk.

The fact that a trader has been audited and found to be compliant reduces the perceived risk of the trader. This allows a customs administration to refocus its attention and limited resources on higher risk traders.

The guiding principle is that, in most countries, 20% of the traders account for approximately 80% of the trade. If customs is able to audit 20% of the traders and ensure they are compliant, customs would not need to devote any significant effort and resources on those operators/ traders at the time of clearance, and instead could concentrate its attention and resources on the remaining 20% of the volume of trade, which represents a higher risk of non-compliance. Such a risk-based audit philosophy needs to be reflected in the organizational structure and resource deployment. Any PCA unit created would need to have the resources and professionally trained staff to undertake comprehensive audits on 20% of the largest traders. Implementation of the 80/20 principle requires that an efficient and effective risk management process be put in place to support both pre-clearance controls and PCA’s. Even in the low risk 20% of the largest traders, it is important to be able to at least randomly check a small percentage of these consignments for document verification and/or physical goods inspection. Where an inspection is required, it should be performed at the trader’s premises when the goods are being off-loaded. Selectivity criteria should be focused on the 20% of consignments that are unable to be subject to PCA. Of course, any consignment suspected of containing concealed narcotics, drugs, weapons, IPR infringing goods, or other contraband must be inspected prior to release.

80 - 20 Principle : In most countries 20% of traders account for 80% of the volume of trade. By initially focusing Post-Clearance Audits on this 20% of largest, high volume traders, Customs could minimize movement controls exercised prior to release of goods for the majority of traders.



DEFINITION, OBJECTIVE, SCOPE AND BENEFITS OF PCA

DEFINITION

PCA is the process of verifying the compliance of a business with customs legislation, through an examination of accounts and other records of that business. An audit-based customs control is performed subsequent to the release of the cargo from Customs' custody. PCA's can be conducted on a case-by-case basis focusing on targeted operators, selected on the grounds of risk analysis of the commodity and the trader, or in a planned, regular way – set out in an annual audit program. Furthermore, the audit could also be used as criteria to offer special treatment to certain economic operators.

The ability to carry out post-clearance checks is essential. It is through these checks that Customs may detect false declarations, without having to inspect the goods. However, customs post release checks are not fiscal audits. They are usually – at least at first – transaction-based. They can take the form of desk reviews, requests for additional information, or field visits/audits to the importers or their clients. In most cases, such checks are more destined to confirm the compliance of importers than to detect a pre-supposed fraud. They normally should not require the same restrictions as a tax audit.

Chapter 6 of the General Annex of the Revised Kyoto Convention sets out a large number of recommended standards relating to all aspects of Customs control, including the use of audit-based controls and the audit of traders' commercial systems (Standard 6.6. and 6.10).

OBJECTIVE

The objective of PCA is to:

- Gain necessary assurance of compliance with customs requirements;
- Correct situations where there is any deviation from full compliance;
- Protect revenues;
- Ensure greater compliance with customs laws and regulations;
- Obtain better control of resources;
- Detect and prevent fraud more comprehensively; and

- Provide more comprehensive control in areas such as licensing, quotas and dumping.

The purpose of such audits is to verify the accuracy and authenticity of declarations and covers the control of traders' commercial data, business systems, records, books.

Introducing PCA reflects a different approach to customs control as it has the effect of offering an immediate release of goods or reduced release times. Implementation of post clearance audit is part of the risk management strategy.

SCOPE

PCA's can take place at the premises of the trader, and may take into account individual transactions, so-called "transaction-based" audits, or cover imports and/or exports undertaken over a certain period of time, so called "company based" audit.

Post clearance audits can cover all customs regimes, i.e. temporary importation, inward processing, duty free zones, end use tariff items, and therefore enhance customs control over some of these regimes, which could not be checked at the border.

PCA allows Customs to change the approach from a purely transaction-based control to a more comprehensive, company-oriented control. Customs audit can benefit from a broader picture of the transactions over a longer period. Details for comparison will come from local or national databases and include information from each customs declaration registered. By comparing prices and tariff headings for identical or similar commodities related to different companies, inconsistencies may indicate fraud.

BENEFITS

Introduction of PCA results in the following benefits:

- *Reduced cargo dwell/release time.* For those traders/operators subject to PCA, normally the dwell time required to complete pre-release customs controls (i.e. while goods are in Customs' custody) will be reduced as compared to those traders/operators subject to traditional customs pre-release control which is based on Customs verifying declarations and/or physically inspecting the goods before release is granted. In applying risk management techniques and audit-based control, the customs authority is able to normally release the vast majority of shipments (up to 80-90% of total imports in most countries) within 2-4 hours of the declaration being submitted. Only those consignments matching identified risk profiles would be subject to detailed documentary verification and/or physical inspection.
- *Reduced administrative and compliance costs.* Many customs administrations offer traders/operators subject to PCA control, reduced or simplified documentary requirements, e.g. simplified declaration, e-filing, or elimination of requirement to submit supporting trade documents with the customs declaration unless specifically requested by Customs.
- *Reduced inventory costs.* Traders subject to PCA and having their consignments released immediately can use, sell or dispose of their goods promptly i.e. almost immediately upon their arrival in the country. This is particularly important for perishable or urgently required goods, and fully supports "just-in-time" inventory control applied by successful manufacturing/exporting enterprises;
- *Reduced cargo storage, demurrage and warehousing fees.*

- *Reduced cargo inspection and related handling fees.*
- *Reduced cargo breakage, pilferage and related insurance claims.* This means savings related to having less cargo damage and fewer insurance claims derived from undertaking fewer cargo inspections. This should translate into fewer insurance claims and lower insurance fees related to breakage or pilferage during the cargo inspection process.
- *Lower transport fuel costs and overall transport charges as conveyances are not detained as long at the border or at inland customs clearance centers.*
- *Additional reassessment/recouping of unpaid revenue.* Auditing of traders'/operators' books and records and systems is a far more efficient and effective way in detecting and deterring customs valuation fraud. Auditors are able to obtain other documents, which are not available at the time of the import clearance, including commercial transactions, which require several shipments. It allows verification of the importer's accounting records in order to confirm the accuracy of the declared value. On-site field audits allow auditors to better detect not only valuation fraud but also other types of false declarations, such as misclassification, misdescription of quantity and origin, etc. PCA's should lead to significant increases in reassessments and notices of claims for collection of duty/tax short-payments.
- *More comprehensive control and verification of requirements related to licenses, permits, certificates, quotas, phyto-sanitary requirements.*
- *Contributes to customs efficiency, trade facilitation and to building an environment for sound investment at national level.*
- *Promotes greater voluntary compliance with customs laws and regulations, by rewarding compliant traders who are subject to PCA with expedited clearance of goods.*
- *Audits also act as a significant deterrent to committing customs related frauds.* Recognizing that they may be subject to audits motivates traders to carefully and accurately declare their goods.
- *Field audits provide the customs auditor an opportunity to assist, educate and advise the importer on customs requirements.*
- *Allows Customs to make more effective use and allocation of scarce human resources.*
- *Gives Customs a clear understanding of the trader's overall ability and interest in complying with customs requirements, which can provide excellent feedback into the customs risk management cycle.*

IMPLEMENTATION

A reporting system should provide management (and the supervisory authorities to the customs service) with adequate evidence of the results achieved by the audit team. It should also be stressed that involvement of local business organizations in the assessment process can be very useful, adding credibility to the evaluation and strengthening cooperation between the customs service and the business community.

B. FINDINGS & RECOMMENDATIONS

COMMITMENT, SUPPORT AND OWNERSHIP

As it is the case with any reform program, the most critical pre-requisite is the firm commitment and long-term support for it of the highest levels in the organization. The RS needs to participate directly in the process of implementing an effective PCA program and supporting risk management, so that in the end, there is ownership and sustainability of this important reform.

STRATEGY AND PLANNING

It is important that PCA activities be reflected in:

- The RS's strategic plan;
- The customs reform and modernization plan;
- Customs operational plans;
- The RS IT strategy;
- The RS human resource strategy;
- The RS training plan; and
- The RS national audit plan.
 - This plan contains key performance indicators and reporting mechanisms for monitoring performance, e.g. the number of desk audits and field audits to be conducted, estimated additional revenue assessed/collected, estimated cost per audit, and return on audit investment.
 - *Recommendation:* Preparing a realistic annual audit plan will be critical to the success of the PCA program. The annual audit plan will ensure optimum use of limited audit resources, i.e. ensuring resources are allocated on the basis of risk to achieve maximum results.

LEGAL FRAMEWORK

It is important that the Tax Code and regulations/bylaws fully support PCA control. Though the Tax Code makes reference to PCA and a bylaw to support audits, no bylaw has ever been issued to support customs PCA's. The following is a list of rights and authorities required to support the conduct of PCA's.

SCOPE OF PCA

The law should specify who is subject to audit. The definition of auditee should include the person or companies directly or indirectly involved in international trade transaction including importers, exporters, customs brokers, freight forwarders, shippers, and carriers. The law should provide for post-release or post-clearance verification of customs declarations. These

verifications can take the form of desk reviews, requests for additional information, or visits to the importer's premises or their client's premises. The law should state that the purpose of these audits is to confirm compliance and detect/deter fraud. The law should allow Customs to extend the scope of its review to external resources, even if they are under control of the other organizations.

AUTHORITIES OF PCA AUDITORS

- Right to conduct a retrospective audit of the business records, including bank records and computer systems, of any person or company involved in an international trade transaction;
- Right to access, i.e. right to entry and to remain at an auditee's premises;
- Right to detain or stop a person or vehicle to conduct a search to determine compliance with customs laws and requirements;
- Right to examine business, commercial records and data relevant to customs declarations and international trade made in the past;
- Right to examine business computer systems;
- Right to examine records and data kept in electronic format;
- Right to make inquiry of auditees;
- Right to inspect auditee's premises;
- Right to take representative samples of goods;
- Right to take copies of documents or electronic data;
- Requirement to return documents upon completion of audit;
- Right to require the auditee to present other documents for the purpose of verifying the accuracy of particulars contained in the customs declaration;
- Right to temporarily retain business records for a specific/adequate period of time e.g. 6 months;
- Right to obtain information necessary for conduct of PCA from external organizations;
- Right to exchange and share information regarding international trade transactions with other customs administrations for customs control purposes;
- Right to extend the scope of the audit by referring aspects of the review to other external resources even if they are under the control of other organizations, e.g. to the Fiscal Investigations Unit if there is evidence of commercial fraud;
- Right to make a claim against the auditee to recover duties/taxes found to be delinquent or short-paid through the audit;
- Right to require the person/company involved in an international trade transaction to submit the information necessary, as previously defined and publicized by Customs, for the completion of customs formalities according to the stipulated procedure and control method;

- Right to require that this information be kept by the person/company involved in the international trade transaction according to the generally accepted accounting principles within the country concerned;
- Right to allow for the periodic lodgment of declarations and to set up systems-based or audit-based controls;
- Right to collect interest or other penalties assessed on any short-payment;
- Right to forfeit the assets and properties owned by the auditee and convert them into cash to settle the delinquent duties/taxes conclusively; and
- Right to authorize persons or third parties to assist Customs in performing certain customs control functions.

LEGISLATIVE PROVISIONS TO ENCOURAGE TRADER VOLUNTARY DISCLOSURE AND SELF-COMPLIANCE

The law should encourage self-compliance by providing auditees with an opportunity to correct/amend a customs declaration before a PCA is undertaken or an offense investigation is initiated. In this case, penalties should not be imposed or should be mitigated.

OBLIGATIONS AND RESPONSIBILITIES OF AUDITEES

- The law should require that such persons/companies maintain records of their international trade transactions, for a specified period of time, e.g. six years;
- The law should define what records are required to be maintained and how such documents should be maintained, e.g. according to generally accepted accounting principles within Georgia;
- The obligation for persons/companies to maintain records of their trade transactions for a specified period of time (e.g. 6 years or whatever period is equal to the period within which the pertinent offenses can be prosecuted). The duration should be equal to the period within the pertinent offenses can be prosecuted; and
- The obligation to provide records/data requested by the PCA auditor in a timely manner (e.g. within 20 working days from date of request).

PENAL SCHEME

Laws and regulations must include provisions to penalize:

- Auditees who evaded, refused to make trade documentation available or obstructed PCA auditors;
- Auditees who failed to maintain books and records and make them available to PCA auditors;
- PCA auditors who executed their authority improperly; and
- PCA auditors who failed to keep the auditee's commercial information or customs restricted information secret.

RIGHT OF APPEAL

All customs matters must be treated in a transparent and fair manner and all persons/companies who deal with Customs must be afforded the opportunity to lodge an appeal on any matter.

The appeal procedure must be clearly outlined in the legislation, and the legal requirements and procedures for filing an appeal must be made readily accessible to the trade community and the general public.

CONSISTENCY WITH RELATED LEGISLATION, LAWS, AND PROVISIONS

The competent national legislation bodies should examine:

- Whether there exist any rules that cause inconsistency with the implementation of PCA; and
- Whether there exist appropriate rules enabling to complete PCA objectives, such as measures rectifying irregularities discovered through PCA.

AUTHORITY AND PROCEDURES FOR THE RECOVERY OF CUSTOMS CLAIMS

National laws and regulations should provide for the recovery of customs claims, stipulating a time-frame in which the recovery can be enforced.

AUTHORITY AND PROCEDURES FOR DELINQUENCY

Where the declarant fails to pay duties/taxes due, national laws regulation should provide for a procedure to forfeit the assets and properties owned by the declarant and convert them into cash to settle the delinquent duties/taxes conclusively.

Recommendation: Technical assistance is given to RS to draft amendments to the legal framework to support PCA's. Proposed amendments should be drafted then discussed with RS management.

STANDARD OPERATING PROCEDURES

There are currently no SOP manuals written for any customs procedures in Georgia. The absence of SOP manuals is a major constraint to efficient and effective customs administration. Such SOP manuals form the basis for:

- Guiding customs officers in undertaking their daily responsibilities and activities;
- Management to exercise proper oversight of their staff to ensure that customs procedures, systems and controls are being properly applied properly;
- Undertaking operational audits of procedures, systems and controls to ensure that fraud and corruption is not occurring;
- Providing staff with customs technical training; and
- Providing traders with information necessary so they can voluntary comply with customs formalities.

Recommendation: Two SOP manuals need to be written to guide the activities of officers responsible for managing risks related to PCA and conducting post-clearance desk audits and field Audits. These SOP manuals should have a structure, content and glossary of

customs terms which will be consistent with the comprehensive set of SOP manuals to be prepared as part of the customs reform and modernization program. They should form the basis for developing technical customs training courses related to risk-based PCA's. These manuals need to be drafted, discussed in detail with RS senior management, then signed-off by the Head of the RS before technical PCA training commences.

HUMAN RESOURCES

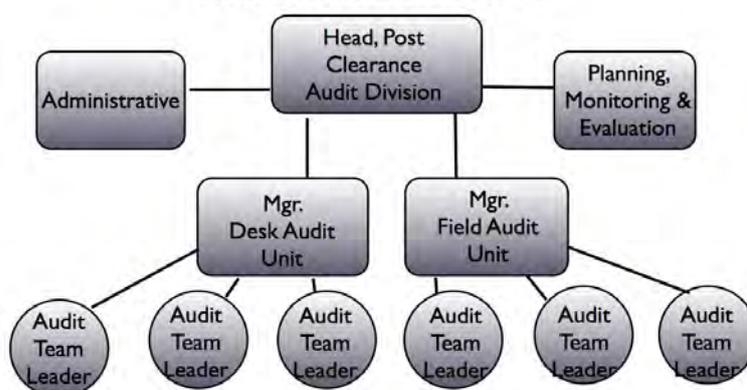
ORGANIZATIONAL STRUCTURE

Customs Post-Clearance Audit Division

This unit was transferred from the Tbilisi Regional Office to the RS Headquarters Audit Department in late January 2011 when the Tbilisi Customs Clearance Office was opened. As with income tax audits, it is highly unusual that such a field or operational activity has been centralized within the RS headquarters organizational structure. Typically, headquarters has the responsibility for developing and implementing policy, SOP manuals and training programs related to customs PCA's, while each region has its own PCA unit that is responsible for actually conducting post-clearance desk and field audits of high-risk traders and their trade transactions which have occurred within that particular region of the country. Headquarters has the responsibility of managing the PCA program on a national level and ensuring there is a consistent and fair approach applied in all regions. Where a trader may be operating in a number of regions, headquarters has a responsibility for coordinating audits being undertaken on a single trader operating in different regions.

Recommendation: The customs PCA program can remain centralized at RS headquarters while the program is being developed and auditors are being trained. Once an adequate number of customs auditors have been trained and have acquired sufficient operational experience in conducting both desk and field audits, the program should be once again decentralized to the regional office level. Decentralizing customs auditors to regional offices would allow auditors to conduct post-clearance field audits in a more efficient manner (i.e. travel costs and the time to undertake a field audit would be significantly reduced if undertaken from a regional office).

Typical Organization Structure of Post-Clearance Audit Division



Risk Management Division

This division has existed in the RS since 2008 and is responsible for risk management related to both customs and tax administration. From a customs risk management perspective, the Risk Management Division has to date focused almost exclusively on maintaining the risk selection criteria in the ASYCUDA system used for selecting high risk customs declarations for detailed documentary review and/or physical inspection prior to release of the goods being granted. The Risk Management Division was initially located in the Revenue Collection Department and then the Administrative Department. In May 2011, the Risk Management Division was transferred from the Administrative Department to the Audit Department, when the Head of the Administrative Department assumed responsibility for Audit. This transfer apparently recognized that risk management was of central importance to conducting more effective customs and tax audits.

Recommendation: The Risk Management Division is the central operational brain of any revenue service. It is responsible for coordinating all intelligence gathering, analysis and risk management for the entire RS. In a nutshell, it controls where Customs focuses its attention and efforts in order to detect and deter fraud. Given its critical importance, the Risk Management Division should be given high prominence within the organizational structure of the RS. Typically, the Risk Management Division is located as an independent division at the highest level of the organization and reporting directly to the Head of the RS. It should not be buried inside an operational department that should normally be functional at the regional level. While the Risk Management Division may remain in the Audit Department in the short-term while risk management related to customs PCA is being introduced. In the medium-term once PCA's are being conducted efficiently and effectively, the Risk Management Division should be an independent division at the top of the RS organizational structure reporting directly to the Head of the RS and coordinating risk management for all customs controls, not simply audit-based controls.

JOB QUALIFICATIONS/DESCRIPTIONS

No job descriptions currently exist for any of the staff or management positions in either the Post-Clearance Audit Division or Risk Management Division. Customs PCA controls must be carried out by professionally qualified and trained Customs personnel. With the increased use of electronic record-keeping and the sophistication of global trade, the need for higher standards of training becomes increasingly important. Customs auditors need to draw on the following knowledge/skills:

- Accounting techniques and principles, including GAAP, auditing standards and procedures;
- A good understanding of international trade/business including banking procedures;
- Electronic record-keeping and computer systems;
- Significant technical knowledge and experience in all aspects of customs control;
- A comprehensive technical customs background in customs laws, tariff classification, valuation and origin; and
- Auditors must exercise their authorities to the highest level of ethical standards with particular emphasis placed on the following virtues:
 - **Confidentiality** - Auditors must keep the secrecy of both auditees and Customs. Likewise, they must pay attention not to disclose Customs' confidential information to the outside;

- ***Due care and diligence*** - Auditors should take maximum care of the auditee's property if usage of such is necessary, and they should not misuse their authority over the auditee;
- ***Equity/Impartiality*** - Auditors are required to maintain fair and just judgment over similar cases and not to treat them arbitrarily; and
- ***Auditor Ethics/Integrity*** - Auditors should by all means be incorruptible, objective and unprejudiced in the performance of their duties. Judgment should be excised without compromising efficiency as well as courtesy for clients. Auditing is inherently open to malfeasance and corruption. It is critically important that checks and balances be put in place to allow RS management to minimize opportunities for corruption and maximize the potential for detecting corrupt practices. It is important that audits do not become repetitive, with obvious implications in terms of harassment and rent-seeking. This is a real danger, but it can be off-set by:
 - *An annual plan of control* – Companies that are not on that plan of control could only be audited if there were sufficient grounds to do so (i.e. a management decision that needs to be documented);
 - *Proper audit findings reports* – Audit reports should be closely monitored by management to detect improper audits and allow audit evaluations where potentially deficient audit procedures have occurred; and
 - *Company feedback* – Companies must be invited to report cases of apparent harassment to senior RS management or an independent body for investigation.

Recommendations: Job descriptions need to be written for management and staff of the Post-Clearance Audit Division and Risk Management Division. An anti-corruption strategy needs to be designed and implemented to ensure that PCA's are performed at the highest level of integrity and ethics.

STAFF COMPLEMENT

CUSTOMS POST-CLEARANCE AUDIT DIVISION

The division currently has 10 customs officers (with one officer on leave) and is supervised by one manager. The vast majority of auditors are female. All 10 customs officers worked previously at various customs clearance offices prior to being transferred into the post-clearance office unit. All interns selected for the Post-Clearance Audit Division had gained sufficient experience and performed well enough to be transferred from the largely clerical „operator' role, to being responsible for reviewing customs declarations at the clearance office. All interns had scored well on a knowledge tested conducted by the RS last year. Taking these test results into consideration, the manager of the Post-Clearance Audit Division and Head of the RS Audit Department selected customs auditors to work in the Customs Post-Clearance Audit Unit. It is also important to note that the division's complement of only 10 customs auditors is not sufficient to perform basic desk audits on the approximately 150-200 Blue Channel customs declarations selected by the ASYCUDA system and sent to headquarters from the various customs clearance offices each day. It is understood that there is currently a backlog of over 1,500 declarations waiting to be verified by the Post-Clearance Audit Division. While it is difficult to accurately assess how many post-clearance auditors are needed, assuming that the RS intends to perform field audits on

20% of the traders that account for 80% of the trade and that these auditors will operate at the regional office, it is reasonable to assume that a minimum of 50 customs post-clearance auditors will ultimately need to be trained. Since the maximum class size for providing customs technical training is 25 persons, the RS would need to select an additional 15 auditors into the Customs Post-Clearance Audit Division to receive the initial round of technical training. When selecting interns for the Post-Clearance Audit Division, it would be advantageous to select those interns that have a business or accounting degree.

Recommendation: The RS will need to select and transfer an additional 15 interns to the Post-Clearance Audit Division to receive basic customs technical training in customs valuation, tariff classification and origin/preferential trade agreements before taking PCA technique training. This selection/transfer will need to coincide with the completion of the SOP manuals and training materials. A second intake of 25 customs interns would need to occur after the first group of 25 post-clearance auditors have gained experience and proven their ability to efficiently and effectively conduct both desk audits and field audits. The second batch of interns would be needed approximately six months after the first group have received their PCA training and had an opportunity to apply the new desk audit and field audit techniques. At this time, some of these auditors could be redeployed to the various regional offices.

RISK MANAGEMENT DIVISION

The division currently has 10 officers and one manager. Eight officers focus on maintaining selection criteria in the ASYCUDA system (import, export and warehouse), while the other two officers maintain the PIRS database for high-risk persons/travelers. The primary role of the unit is to ensure that risk selection criteria chosen do not result in rates of referral or physical inspection above accepted norms.

Recommendation: The number of staff in the Risk Management Division devoted to customs risks appears reasonable.

REMUNERATION/BONUSES

Most customs administrations consider their customs auditors to be the cream of their organizations (along-side fraud investigators and narcotics officers). To be an effective auditor, customs auditors need broad-based customs knowledge and experience, which is normally obtained only after at least 10 years of experience working in different areas of customs operations including declaration verification and physical inspection of goods. Customs auditors ideally should have a business or accounting educational background so they can understand traders' accounting systems. They should receive specialized training in auditing techniques, and a few auditors should have additional specialized training in auditing IT systems. Given the nature of the auditing, there are inherent risks of auditors becoming involved in corruption and collusion. Therefore, auditors must be sufficiently remunerated and motivated.

Recommendation: The RS needs to ensure that customs post-clearance auditors receive an adequate salary comparable to what they would earn in the private sector as an auditor. Consideration should also be given to introducing performance-based bonuses or other motivational incentives for auditors. In some customs services, these incentives may be related to additional revenue assessed/collected from conducting an audit.

AUDIT TRAINING AND CAPACITY BUILDING

Customs staff must be trained to fully understand the effectiveness of PCA's. Furthermore, training courses must be provided to create awareness of the analytical work that is necessary to take advantage of the system. Training in common book-keeping methods and audit methods may also be required.

POST-CLEARANCE AUDIT DIVISION

While the 10 customs interns currently assigned to the Customs Post-Clearance Audit Division are promising, none of these officers has yet received any formal technical customs training beyond the basic induction training provided at the Police Academy and on-the-job training by supervisors at the Gezi's. The induction training at the Police Academy was designed primarily to assess/screen applicant interns (i.e. whether or not the RS would offer them a probationary job as an intern). Therefore, this induction training was never designed to be a comprehensive technical customs training course.

Recommendation: Customs intern auditors must receive additional level technical customs training courses in customs valuation, H.S classification, and origin/preferential trade agreements. It is important that intern auditors have a comprehensive foundation and understanding of these key areas before they receive a technical training course in post-clearance auditing techniques. It is estimated that delivery of the H.S. classification, customs valuation and trade agreement courses would take approximately six weeks (two weeks per course). It is envisioned that the PCA training would be spread over three courses, each of two- week duration. The first course would cover customs post-clearance desk audits. A second course would cover customs post-clearance field audits. A third course would cover auditing of trader IT systems. These courses would be delivered over a six-month period as auditors obtained experience in conducting desk audits, before attempting field audits and subsequently trader IT audits.

RISK MANAGEMENT DIVISION

Only the division's manager has received any formal risk management training, including a basic risk management training course given by Chemonics approximately four years ago during the previous USAID-financed project, and a two to three day study tour arranged to visit other customs services using risk management. Apparently, all the customs officers that received this training/participated in the study tour have been since retrenched. The division's manager also received some risk management training from UNCTAD when the ASYCUDA selectivity module was implemented. Clearly, training and capacity building in customs risk management is urgently required so that the Risk Management Division can support the Post-Clearance Control Division when selecting high-risk sectors, firms and transactions to conduct both desk and field audits.

Recommendation: It is important that all staff in the Risk Management Division receive a customs risk management lifecycle training course. This course would convey international best practices regarding customs risk management as espoused in the Revised Kyoto Convention and the WCO Risk Management Guideline. This one week training course in customs risk management would take the form of an interactive workshop that would lead participants through each step in the risk management lifecycle. The training would identify all the steps and activities involved in risk management and would give managers an opportunity to discuss at both a strategic and operational level all specific risks facing Georgian Customs. The seminar should assist the RS in improving its internal and external intelligence gathering, risk identification and analysis/assessment process, critical feedback mechanisms, and ultimately the relevance, timing and effectiveness of selection criteria

processed by ASYCUDA (i.e. the enforcement results achieved and additional reassessments collected).

It may also be possible to invite a vendor of commercially available risk management software (e.g. Greenline Systems, which supplies risk management software solutions to U.S. and Canadian Customs, as well as various ASYCUDA user countries in the Caribbean) to be a guest speaker at some point during this risk management training. This guest speaker could inform and give a demonstration to participants of how other customs administrations that use ASYCUDA can use their risk management software to further strengthen their risk management cycle and increase enforcement effectiveness.

INFORMATION TECHNOLOGY

POST-CLEARANCE AUDIT DIVISION

While interns posted to this division currently have basic user access to ASYCUDA (i.e. as an „operator“), only the manager has been granted a password to request retrievals, data mine the ASYCUDA database and produce statistical reports to support the PCA function. While this authority has been provided to the manager, required technical training has yet to be given.

Recommendation: All staff posted to the Post-Clearance Audit Division must receive additional ASYCUDA technical user training and be given a password to allow them access to the ASYCUDA database. This training should be provided by qualified staff in the IT Division conversant with these aspects of the ASYCUDA World. This ASYCUDA training would allow PCA staff to efficiently and effectively retrieve declaration data and produce statistical reports, in order to analyze and select high-risk traders and particular high risk transactions to audit. In addition, staff of this division need to be given direct access to the current customs valuation reference price database so that they may compare declared customs import values of goods with those values/reference prices maintained in the database. Currently, only particular staff in the Expertise Unit located at the Gezi have access to the reference price database. Without access to the reference price database, there is no guarantee of consistency between how the Expertise Unit would check the declared customs value of goods and how the Post-Clearance Audit Unit would check the declared value of „like or similar“ goods during their PCA. It is important that a tariff classification rulings database be developed such that H.S. explanatory notes and all international and national tariff classification rulings are available on-line to staff (and stakeholders). This would ensure that there is greater transparency, consistency and less discretion in how goods are classified by Georgia Customs, whether that is pre-release control or on a PCA basis.

RISK MANAGEMENT DIVISION

While it is understood that this division has access to the PIRS database, a BlackList and a database listing previous offenses by traders/taxpayers, the Risk Management Division does not have access to all sources of intelligence or enforcement data to assist it in assessing customs risks. It is understood that few if any suggestions regarding customs risks or selection criteria are being sent to the Risk Management Division from the Economic Border Protection Department, the Customs Clearance Offices, the checkpoints and X-Ray scanning unit, and rarely from the Tax Audit Department or the Customs Post-Clearance Audit Division (though it is understood that the customs Post-Clearance Audit Division manager is now a member of the Risk Management Committee). Similarly, it is rare to receive any intelligence or risk information from the Ministry of Finance Fiscal Investigations

Unit or from the Police. Apparently this situation exists because most officers are afraid of suggesting to add, remove, increase or decrease selectivity criteria, fearing that they may be held accountable and face disciplinary action (including dismissal, which is a frequent occurrence in the RS) if a consignment were to get past customs controls.

Consequently, most customs officers display a laissez-faire attitude, preferring to allow the Risk Management Division in general and the ASYCUDA system in particular to make the decisions on what declarations need to be verified and/or what consignments need to be physically inspected. It is also very disturbing to learn that most customs officers responsible for inspecting cargo are not filling out the inspection results feedback form in the ASYCUDA system, or if they do occasionally fill this form out, the quality of the information input is of such poor quality that it is largely useless for determining whether or not a selection criteria has produced any results. It is critically important that this situation be corrected by Gezi management immediately, otherwise the on-going lack of feedback from the few cargo inspections actually being undertaken prevents the Risk Management Division from analyzing the effectiveness of the selection criteria loaded in ASYCUDA. Without feedback from the Economic Border Protection Department, cargo clearance centers, border checkpoints and X-Ray scanning units regarding the results of import declaration verifications and cargo inspections generated by the Risk Management Unit, the RS cannot operate an effective risk management process. The RS Risk Management Committee, which is chaired by the Head of the RS, has of late not been meeting on a regular/scheduled basis.

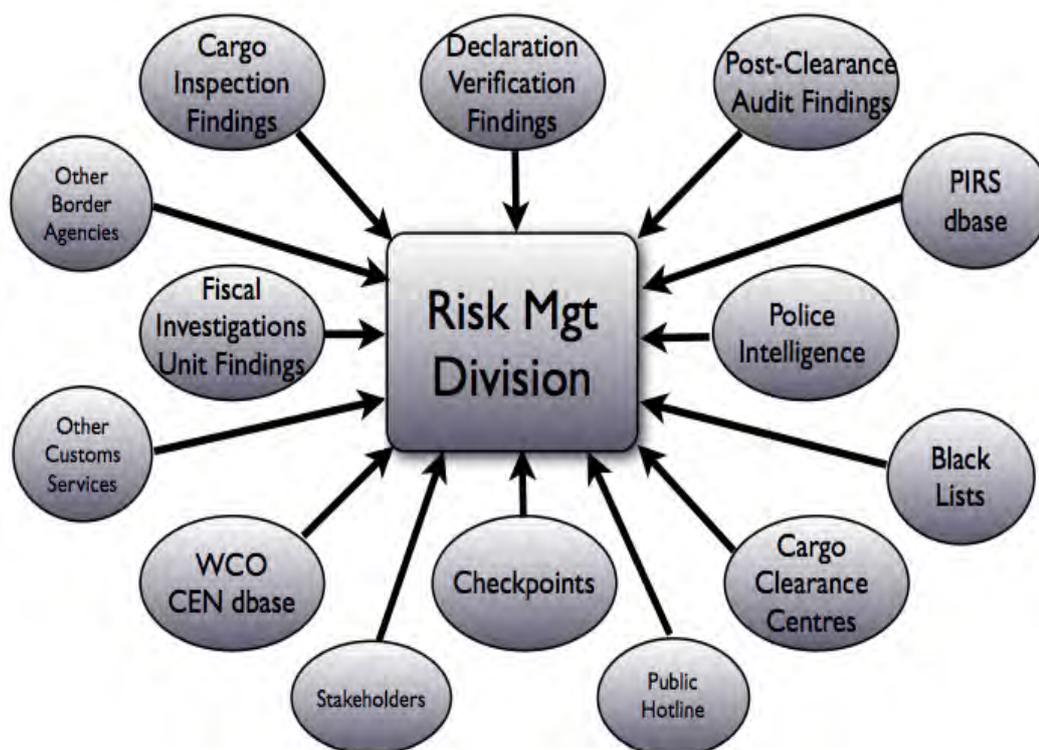
Recommendation: The Risk Management Unit should be given direct access to the WCO's Customs Enforcement Network, which is currently only available to management in the Economic Border Protection Department and the International Affairs Department. This important database contains all major enforcement actions taken by customs administrations around the world and could provide information of vital importance related to customs risk management. Feedback on the results of import declaration verifications and cargo inspections at checkpoints, customs clearance offices and X-Ray scanner operations need to be accurately input into the ASYCUDA system to allow risk management to closely monitor results achieved from specific selection criteria, and where no results are being achieved to adjust risk selection criteria in the ASYCUDA system in a timely manner. The Fiscal Investigations Unit and Police should both participate more actively in the risk management process, providing timely intelligence and feedback. Other border agencies, intelligence from other customs services and the RS Phyto-Sanitary Department should play a more active role in risk management. Stakeholders and the general public (through a toll-free hotline or website) should be encouraged by the RS to provide input/feedback into the risk management process. It is recommended that that Risk Management Committee's mandate, member composition, reporting methods and frequency be analyzed and a strengthened Risk Committee be established. In this regard, it may be appropriate to have separate working committees with customs and tax administration, as well as create risk management sub-committees, which would meet regularly on specific customs controls and risk areas including:

- Air cargo;
- Rail cargo;
- Express consignments and postal;
- Sea cargo;
- Narcotics;
- IPR enforcement;

- X-Ray scanners;
- Transit control; and
- PCA controls.

The risks and selectivity criteria identified in these sub-committees would be forwarded to the national Risk Management Committee for consideration/approval.

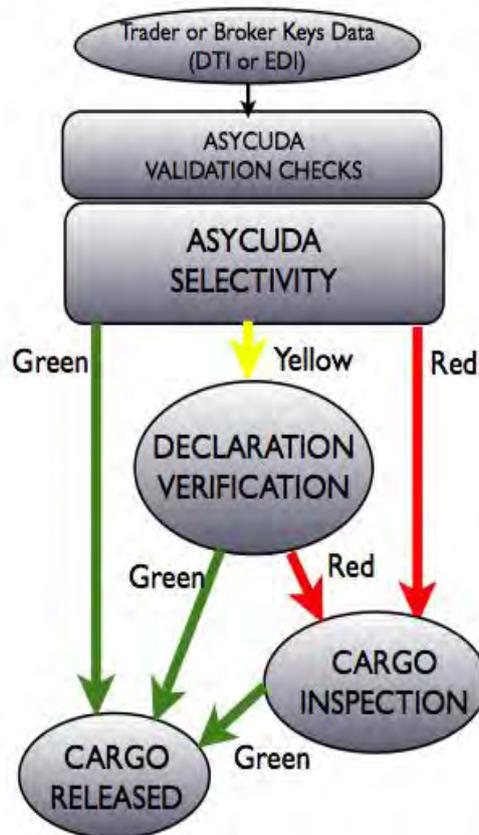
Risk Management Inputs/Feedback



IMPORT DECLARATION RISK CHANNELING

Automated risk channeling is a key feature of any modern customs administration. It is the mechanism by which risk profiles and risk selectivity/criteria are applied on customs declaration data to identify high-risk consignments that have met specific criteria and which should be subjected to detailed document verification and/or cargo inspection. International best practice typically dictates the following customs import declaration processing and risk channeling:

Typical Customs Risk Channeling



Most modern customs administrations no longer manually key data into their automated declaration processing system (such as ASYCUDA). The declarant (i.e. either the importer or his agent/customs broker) is required to prepare his own customs declaration (i.e. make a self-declaration or self-assessment of the goods being imported, then key/transmit the completed customs declaration data into the customs computer system. This keying normally occurs at the declarant’s premises/office, and is then transmitted to the customs computer over the Internet or via a dedicated communication network. This electronic submission of declarations is known as Electronic Data Interchange (EDI). For those declarants that do not have access to the Internet or the dedicated network, some customs services provide a dedicated room at the checkpoint or customs clearance office with dedicated terminals where the declarant may data enter his customs declaration. Once entered into the customs computer, the system automatically validates the declaration for completeness and the data for accuracy. Once acceptable, the customs system processes the declaration data against risk selectivity criteria in order to identify any declaration that requires a detailed documentary review and/or any goods that require a physical inspection. These selectivity criteria can be any single or combination of data elements found on the goods declaration. Alternatively, it can be a purely random selection. Typically, the system assigns the declaration to one of three processing channels, and if selected, also specifies the reason(s) why the declaration has been given a particular channel.

GREEN Channel is given to those declarations that have not met any selection criteria. Most customs services target at least 50-60 % of import declarations to receive Green Channel; however, such a high percentage normally requires Customs to be operating an

efficient and effective PCA program to verify the trader's compliance through PCA as opposed to pre-release movement controls.

YELLOW Channel is given to those declarations that require detailed document verification (i.e. checking of supporting documents such as invoices, certificates of origin, manifests, etc.) against the data declared on the goods declaration. Frequently goods that are assigned Yellow Channel require customs to verify the tariff classification, declared customs value or origin of the goods. It is not uncommon for 30-40% of declarations to be sent Yellow Channel for various reasons. Normally the automated system clearly specifies the reason why a particular declaration should be checked. To avoid delays in the release of goods due to such a large number declarations sent Yellow Channel, many customs services implement, in the automated system, an automatic switch of the declaration from Yellow to Green after a specific time limit is reached, e.g. four hours after the declaration is submitted. This gives Customs adequate time to check the declaration and supporting documents, while also guaranteeing an internationally acceptable release time standard. During the document verification, normally the customs officer has the discretion of changing the Yellow Channel to Red Channel if there appears to be a lack of information, inconsistencies in the declaration or some other identified risk. Normally, a manager's authorization is required to change the channel of a declaration.

RED Channel is given to those declarations which require a physical inspection of the goods to verify quantity, quality, and weight or that the physical goods are actually those declared in the import declaration. Most customs services in developing or newly industrial countries set inspection targets of 10-15%; however, most have cargo inspection rates above this target. During the inspection of the goods, the customs officer may also undertake a detailed documentary verification of supporting documents. Once the goods are inspected and no anomalies are found, the inspection officer is required to complete the inspection findings report in the system. This is required regardless of whether or not any anomaly is found.

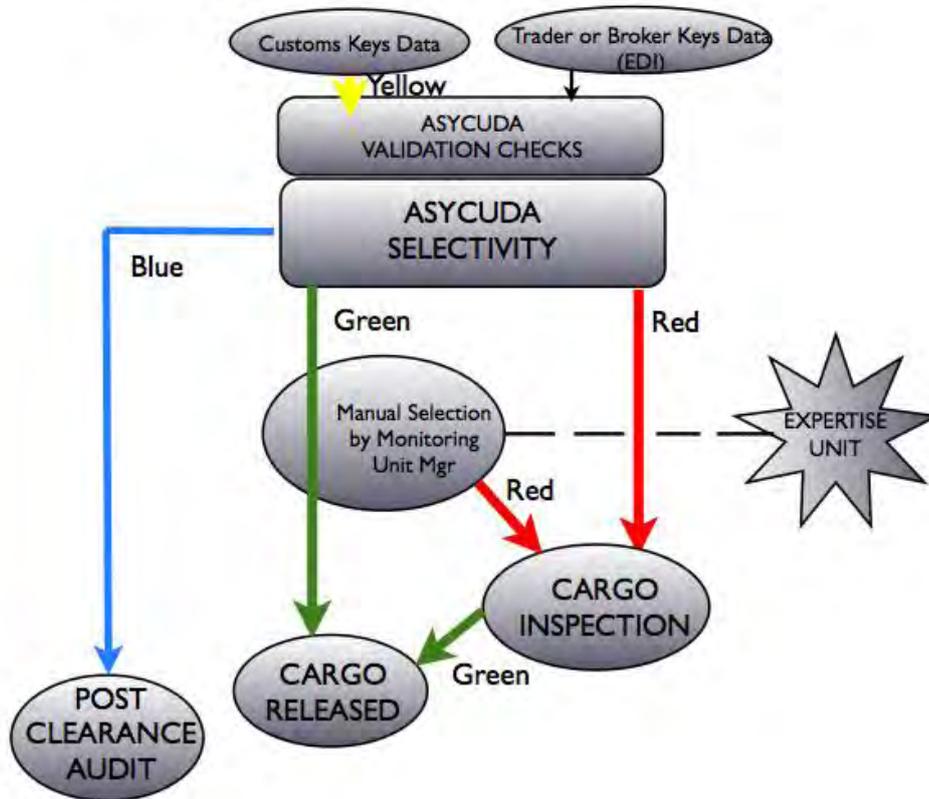
Other Channels - It is important to note that in some countries, there may be other risk channels. The most common "other channel" is the Orange Channel, which is used for those consignments, which need to meet requirements of other government agencies, e.g. phyto-sanitary, standards, licensing or goods awaiting special inspection, sample taking and laboratory testing/analysis requirements. Since the RS includes phyto-sanitary within its organization structure, the introduction of such a channel may have some merit, since it would control those consignments, which have met customs release requirements but may have release pending due to non-compliance other border agency requirements.

Normally there is no channeling performed by the automated system on a pre-release basis for purposes of post-clearance auditing. By definition, any PCA of declarations occurs after the goods are released. Because the decision whether or not to audit a trader's books and records can be taken after the goods are released, there is no need to select individual transactions for an audit. Indeed, the selection of which traders and which of his declarations to audit should not be contingent on how the declaration data was entered into the customs computer system or what channel the declaration was automatically channeled prior to release being granted. To be clear, risk management and automated selectivity related to customs post-clearance auditing should not be done on a transaction -by-transaction basis before the clearance of the goods. It should be performed on a post-release basis, with the PCA examining a trade sector's overall risk, and within that, those specific trade transactions of an individual high risk operator/trader.

GEORGIA CUSTOMS RISK CHANNELING

The above typical/international best practice risk channeling is significantly at odds with the current channeling applied by Georgia Customs at its Gezi's.

Georgia Customs Risk Channeling



GREEN Channel - It is understood that upwards of 95% of customs declarations are currently being assigned Green by ASYCUDA.

YELLOW Channel - Based on the logic that the majority of import declarations are now keyed by Georgian Customs officers known as “operators,” Georgian Customs has decided in January 2011 to eliminate the Yellow Channel. The rationale for this decision is that because Customs officers/operators are in fact preparing the vast majority of import declaration for traders and keying the declaration data into ASYCUDA, operators are in presence of all trade related documents, and therefore, are in fact performing a detailed documentation verification on all such declarations while they are preparing and keying the declaration. The decision to eliminate the Yellow Channel has a number of fundamental weaknesses:

- Operators have never received any formal customs technical customs training in tariff classification, valuation or origin/trade preferences. Almost all technical training received has been on-the-job. Therefore, it is highly unlikely that operators currently have the necessary technical knowledge or skills to undertake a detailed declaration verification;

- Operators are being placed in a very exposed situation when required to create/key the declaration into the ASYCUDA system face-to-face with the trader or his representative. This is especially a concern since operators are in fact determining the tariff classification and trade preferences, as well as making key decisions regarding the customs value of the goods, as opposed to the situation in most countries where customs officers are verifying the declarations by the trader. Most modern customs services would not consider allowing such a situation to exist given the high-potential risk for collusion/corruption between the customs operator and trader. The risk is particularly high given the very high percentage of declarations being granted Green Channel and the absence of any back-office Yellow Channel checking of declarations prior to clearance. Indeed, most customs services are implementing strategies that minimize to the extent possible all direct contact between customs officers and traders. Most modern customs services maintain a physical and even sight barriers between traders and customs officers to minimize opportunities for corruption or at least speed money/tips, with all interfaces between officers and traders under close monitoring, e.g. CCTV and audio recording.
- Operators do not have access to detailed reference information normally available to officers undertaking detailed documentary verifications on declarations channeled Yellow. For example, operators do not have access to:
 - The reference price valuation database;
 - H.S. tariff classification rules of interpretation rulings issued (international or national rulings);
 - Trade agreements or phyto-sanitary requirements; and
 - Databases of blacklists or previous customs offenses.
 - All of which could assist the operator in deciding whether or not to request that the risk channel be changed to Red.
- There is no risk management/selectivity criteria related to pre-release detailed documentary review currently processed by the automated system. It is unrealistic to believe that operators are capable of remembering all the combinations of data elements that can identify a risk, and therefore, require detailed document verification when preparing a customs declaration. The fact that clerical operators are largely keying data from trade documents presented by a trader is no guarantee that risks are being properly identified by customs and appropriate control action taken.
- The back-office Monitoring Unit quickly manually scans Green channel declarations prepared by the operators. This quick manual check through a pile of Green Channel declarations is largely random, when time allows. It is designed to pick up obvious clerical mistakes made by the operators when preparing and keying the declaration and providing further on-the-job training to the operator that has made an obvious error. The Monitoring Unit is not designed or staffed as detailed document verification from a risk management perspective. The role of the Monitoring Unit is to simply quickly monitor the quality of the administrative/clerical work performed by the new and inexperienced interns acting as data entry operators, with any technical classification or valuation questions sent to the Expertise Unit. The Monitoring Unit should be incorporated with the Expertise Unit to create a back-office Commodity Specialist Unit that would undertake detailed document verification on Yellow Channel declarations.

RED Channel - It is understood that about 5% (reportedly increased by the Risk Management Division during the mission to 7%) of import declarations are currently Red Channeled and require a physical inspection. While such a low rate of physical inspection may be consistent with the rate of customs inspections found in major airports/ports of some of the most developed countries (e.g. Rotterdam and Singapore), such a low rate of cargo inspection is achieved because Customs is applying sophisticated risk management techniques on all customs controls at each stage of the cargo clearance process (i.e. including advance/pre-arrival manifest and declaration data). In addition, such customs services in developed countries are making maximum use of non-intrusive inspection techniques, including X-Ray screening technology to reduce the rate of cargo that needs to be actually un-stuffed from a container. Georgian Customs is attempting to emulate such low rates of inspection without having first put in place:

- A professionally trained cadre of customs officers;
- A comprehensive risk management system;
- Effective use of pre-arrival data;
- Effective use non-intrusive inspection technology;
- Adequate back office controls to review high risk customs declarations prior to release of the goods; or
- An effective PCA system to ensure compliance of traders after the goods have been released.

BLUE Channel – This is used to channel individual import declarations to the post clearance audit, which is now located at the RS headquarters. Declarations channeled Blue are not subject to any documentary verification or cargo inspection prior to release. It is understood that the declarations channeled Blue are primarily those which have been e-filed (i.e. not data entered by Customs operators). Of these e-filed declarations, the primary selection criteria used is random selection. The Risk Management Division stated that they are currently reviewing this approach after the Risk Management Division was recently transferred to the Audit Department that also contains the Customs Post-Clearance Audit Division. Selecting Blue channel declarations on a transaction-by-transaction, individual declaration-by-declaration basis at time of release, when there is no longer any opportunity to inspect the goods, is not consistent with international best practice, especially when such declarations must be forwarded for checking/verification to a Post-Clearance Audit Division now located at the RS headquarters in Tbilisi.

If the primary purpose of these PCA's is to check the declared customs value on a particular consignment, most customs services would simply channel the declaration to Yellow, such that a detailed document verification could be undertaken at the customs clearance office. Experienced back office customs officers would check the accuracy of the tariff classification, origin and/or declared value against the valuation reference database to assist them in determining whether the customs value declared is consistent with recently imported "like or similar goods." If the declared value is not consistent with previous customs values for recently imported goods, Customs would formally request that the trader supply additional information to support the declared value (i.e. would request that the trader provide copies of bank transfers, letters of credit, price-lists, catalogues, contract of sale or the like, as evidence to support the declared customs value.) If the importer was not able to provide such information quickly and wished to clear his goods immediately, the trader would be required to pay the duty/tax or post a security bond sufficient to cover the additional

duty/tax as assessed by Customs based on their reference prices. If the trader was not able to provide the requested evidence to support his declared value within the prescribed timeframe (e.g. usually 30 days), Customs would keep the additional duty/tax assessed or security bond posted. If the trader were able to provide evidence to support the declared value and this evidence was found to be acceptable to Customs, the additional duty/tax assessed or security bond would be returned to the trader.

It is important to note that this process of separating release from clearance where there is a dispute on customs value (or tariff classification or origin) is internationally accepted best practice and recommended in both the WCO Revised Kyoto Convention and the WTO Agreement on Customs Valuation. While Georgia Customs states that it offers traders such an option when the value or classification is challenged, rarely is this option taken up by traders. Apparently, Customs (normally the Expertise Unit located at the back office at the Gezi) and the trader are almost always able to reach agreement or compromise. Indeed, there have been only three disputes referred to the Ministry of Finance in recent memory. This is a highly unusual situation since, in most countries, Customs regularly challenges the customs values declared by traders. Indeed, in many countries, such challenges are frequently in the range of 5-15 % of all import declarations submitted, especially if there is perceived to be a high rate of valuation fraud or a low rate of voluntary compliance by traders, which certainly appears to be the case in Georgia.

Indeed, most managers interviewed, including the manager responsible for the Post-Clearance Audit Division, stated that under-valuation and fraudulent invoicing are perceived to be the main source of customs revenue loss. It is not clear whether customs officers are simply afraid to challenge declared values for fear that an importer may complain about poor customer service and lack of trade facilitation. It is also possible that customs reference prices are widely known by traders and traders simply ensure that the value appearing on the commercial invoice is consistent with the reference price found on the customs valuation database (whether or not the price declared is the actual price paid or payable). As is the case in many customs administrations, there can be collusion between traders and customs officers, with bribes given so customs officers simply accept without question the value stated on the invoice. Given the large number of declarations automatically assigned Green Channel by the ASYCUDA system, and the absence of any systematic rechecking/auditing of customs declarations against the valuation reference database to detect such malfeasance, it is impossible to confirm why Customs is not challenging more declared values and reassessing more duties/tax payable.

Recommendations: RS Customs at Gezi's/customs clearance offices should take a more proactive stance in challenging goods, which appear to be undervalued. Consideration should be given to giving "operators" access to the valuation reference price database. As more declarations are channeled Yellow, requiring detailed document verification, it is important that more specialization in back office customs officers staff be built. Consideration should be given to setting up a Commodity Specialist Unit (i.e. combining Monitoring and Expertise Units into a Commodity Specialist Unit.) This unit would be organized by high-risk commodity groupings to allow officers to better understand and follow trade issues within specific sectors (e.g. auto spare parts, equipment, chemicals, clothing/garments, foodstuffs, motor vehicles, etc.) Declarations channeled Yellow could be routed to the appropriate specialized officers and a quick turn-around of declarations could be encouraged with the implementation of an automatic release (i.e. automatic change from Yellow to Green within a prescribed time limit of four hours, for example, if Customs has not already made a status change in the system). This would guarantee that goods release is not negatively impacted by strengthening of the document verification function prior to the release of goods.

GOLD LIST TRADERS

RS Customs currently offers approximately 165 Gold List companies expedited clearance privileges. To be approved for the Gold List, firms must meet minimum turnover requirements and agree to e-file their customs declarations and periodically e-pay duties/taxes. Gold List firms are subject to a very low rate of documentary verification or physical inspection of their goods at the time of release. Indeed, it is understood that over 99% of Gold List declarations are given Green Channel, with less than 1% of import declarations from Gold List traders being sent to either Yellow or Red Channel. Since Gold List firms e-file their declarations, customs officers stated that they do not have in their possession the hardcopy supporting documents necessary to check the declarations or inspect the goods.

The Revised Kyoto Convention recommends that customs administrations give large and compliant authorized traders expedited clearance privileges, including lower rates of documentary verification and physical inspection (or at least where an inspection is required, that the inspection occurs at the trader's premises when the goods are being un-stuffed from the container.) However, the Kyoto Convention also recommends that such authorized trader schemes require that traders must undergo a compliance audit prior to being granted such privileges. The compliance audit would confirm that the trader is in fact audit-able (i.e. is keeping proper books, records and systems to allow Customs to verify compliance on a post-clearance basis), and is compliant with customs requirements (i.e. his imports are properly classified, valued, etc.) Once approved, operators should undergo periodic compliance audits to reconfirm that the trader is still compliant with customs requirements.

Gold List firms in Georgia were granted and have now enjoyed these privileges for a number of years without having undergone any initial compliance audit of their books, records or systems, and no periodic follow-up compliance audits. Georgian Customs has allowed these firms significant trade facilitation benefits without ever confirming they are audit-able or compliant, while exercising few checks on Gold List traders' import declarations or inspection of consignments. The RS is assuming this major risk, since international experience has shown far too often that large traders can be involved in fraudulent activities when they realize that no control is being exercised on them, and that the extent of the revenue loss can be significant given the turnover of these companies.

A number of senior managers were asked whether they perceived Gold List firms as a potential risk. There is an almost unanimous response that:

- These firms were surely compliant;
- They must continue to receive maximum trade facilitation; and
- There was little need to perform any cargo inspections at Gold List premises or subject them to PCA's.

However, this faith in the compliance of Gold List companies was not shared by many middle managers, rank and file officers or the private sector representatives interviewed, who viewed the privileges being received by Gold List firms with great suspicion.

While many Gold List firms may in fact be highly compliant, there is an urgent need to at least confirm such compliance. Select Gold List firms should to be subjected to customs PCA's as a matter of priority, and the practice of random inspection of cargo at Gold List premises instituted when goods are being un-stuffed from containers. The introduction of

such controls would provide the RS with some degree of immediate checks and balances on these high-volume firms.

RECOMMENDATIONS

In the short-term, Customs should:

- Encourage traders to e-file their declarations by increasing fees charged for this data entry function and offering direct trader input terminals at checkpoints and Gezi's. Specific objectives should be set to reduce data keying by Customs over the next 18 months, e.g. 75% of total import declarations e-filed by end of 2012 and 95% e-filed by end of 2013.
- Risk management criteria for Blue Channel would be changed significantly (i.e. move away from random selection of e-filed declarations to selective desk audits based on a comprehensive risk management cycle. Only declarations from specific sectors and traders deemed high-risk by the Post-Clearance Audit Division would go through the Blue Channel.
- The Post-Clearance Audit Division should commence desk audits on the highest-risk Gold List firms. Within a year, as technical training is given, additional auditors are assigned, and capacity is built within the Post-Clearance Audit Unit, field audits of Gold List firms would commence. Selective auditing of Gold List traders would confirm their compliance and eligibility to continue to receive the privileges of the program.
- Customs should commence undertaking selective cargo inspections of Gold List traders' consignments, performing such inspections at the trader's premises when the goods are un-stuffed to ensure that release times are not affected. This would allow Customs to detect any enclosures and overages that are unlikely to be detected through PCA's.
- The Post-Clearance Audit Division should commence data mining to identify high-risk sectors, firms and transactions on which they should undertake a desk audit. The direction of such data mining will arise following implementation of an effective risk management cycle (described later in this report).

In the medium term, Georgian Customs should:

- Bring its import declaration risk channeling in-line with international best practice (i.e. Red, Yellow and Green), possibly adding an Orange Channel for goods having phyto-sanitary and other border agency requirements.
- Implement a Yellow Channel at all customs clearance offices. The Monitoring and Expertise Units should be combined with additional staff assigned to create a Commodity Specialist Unit. This unit would be organized by different chapters of the tariff where there are perceived risks in tariff classification and valuation, e.g. auto spare parts, foodstuffs, building supplies, garments, etc. Organizing the declaration verification function by commodity specialization is consistent with international best practice and allows officers to more easily understand particular trade sectors, commodities and trends in pricing, etc. Once this unit is fully operational, it would be possible to direct more Yellow Channel declarations for verification prior to release. Consideration should be given to setting a maximum time-limit in ASYCUDA for Yellow channel declarations to turn Green, e.g. four to five hours. If Customs has not

changed the Yellow channel to Green within this period, it would automatically do so unless Customs had turned the declaration Red. This feature currently exists in ASYCUDA World, but is not utilized. It would allow Customs to exercise greater control at the time of release while guaranteeing reasonable release times for traders.

- Change the proportion of declarations processed through each channel in order to achieve a more realistic balance between facilitation and control. This will require putting in place a more effective risk management process (described later in this report). It will also require redeploying customs officers from largely administrative data entry tasks to higher value compliance verification functions including declaration, verification, physical inspection of cargo, and PCA of high-risk traders' books, records and systems.
- Bring risk channeling rates in-line with international best practice e.g.:
 - Red 10-15%;
 - Yellow 20-40%;
 - Green 45-70%; and
 - Eliminate the Blue Channel, once the Post-Clearance Audit Division has been reformed as proposed in this report. The concept of randomly selecting at the time of release individual, transaction-by-transaction import declarations for PCA should be replaced with a post-release risk-based selection of high-risk traders and specific transactions of which the Post-Clearance Audit Division would undertake a initial desk audit, and if necessary, conduct a field audit of the trader's books, records and systems.

MUTUAL ADMINISTRATIVE ASSISTANCE AGREEMENTS WITH OTHER CUSTOMS SERVICES

Auditors conducting PCA's can benefit significantly from exchanging information with other customs services. Mutual administrative assistance agreements signed by the RS and other customs services can be used to facilitate the receipt of requested export declaration data/documents or bank funds transfer information, which can be used to verify declared customs values. Information exchanged between customs services can assist in risk management. Other provisions in mutual assistance agreements that can be of direct benefit to control efforts include verification of certificates of origin and transit documents. It is understood that the RS has signed a number of mutual administrative assistance agreements. In this regard, the WCO has recently adopted a revised model bilateral agreement for the proper application of customs law and for the prevention, investigation and combating of customs offenses. The WCO also has a multilateral Convention on mutual administrative assistance for the prevention, investigation and repression of Customs offences (the "Nairobi Convention," June 1977).

Recommendation: Current mutual administrative assistance agreements should be examined, and if necessary, amended to ensure they fully support PCA requirements.

COOPERATION WITH STAKEHOLDERS

PCA's may be undertaken on the premises of traders if Customs requires additional documentation or examination of systems to verify compliance. Therefore, it is important to

establish a positive and cooperative atmosphere between auditors and the traders. It is important that all stakeholders be able to obtain information from Customs about PCA procedures and control requirements to facilitate their voluntary compliance with them. The RS website needs to be updated, so that all information related to PCA is clearly spelled out. Many customs administrations now maintain formal consultative committees with all stakeholders. The role of such committees typically includes the discussion of projected changes in control requirements, identification of difficulties experienced by declarants in complying with actual or proposed procedures and arriving at mutually acceptable solutions. In addition, some customs administrations have introduced the idea of “client coordinators” who keep contact with individual companies. Such collaboration and consultation is essential when a PCA program is introduced. There should be continuous collaboration at all levels; at local/regional levels between customs officials and business and at the national level between customs administrations and business. MOU’s may be concluded between Customs and stakeholders impacted by PCA’s.

Recommendations: An appropriate stakeholder education campaign must be launched to ensure that stakeholders are aware of the Post-Clearance Audit Division’s mandate, modus operandi and benefits. The Post-Clearance Audit Division needs to work closely with taxpayer services to ensure that all stakeholders are fully informed about PCA requirements. This includes updating the RS website and signing MOU’s with stakeholder associations to ensure the trader is fully informed and can voluntarily comply with PCA requirements, i.e. the exchange of information and documents to facilitate audit verification.

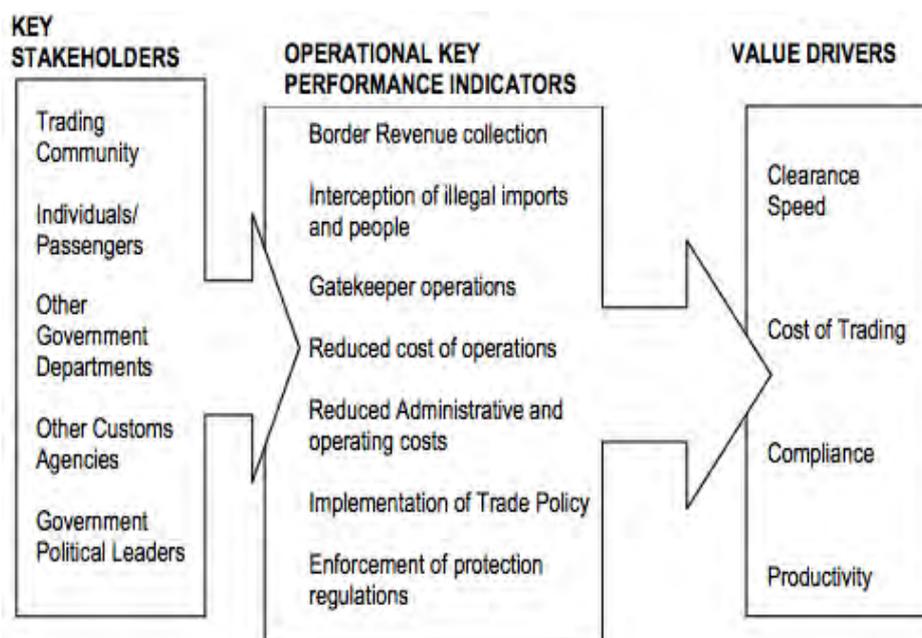
RISK MANAGEMENT: CORNERSTONE FOR EFFECTIVE PCA’S

RISKS AND RISK MANAGEMENT

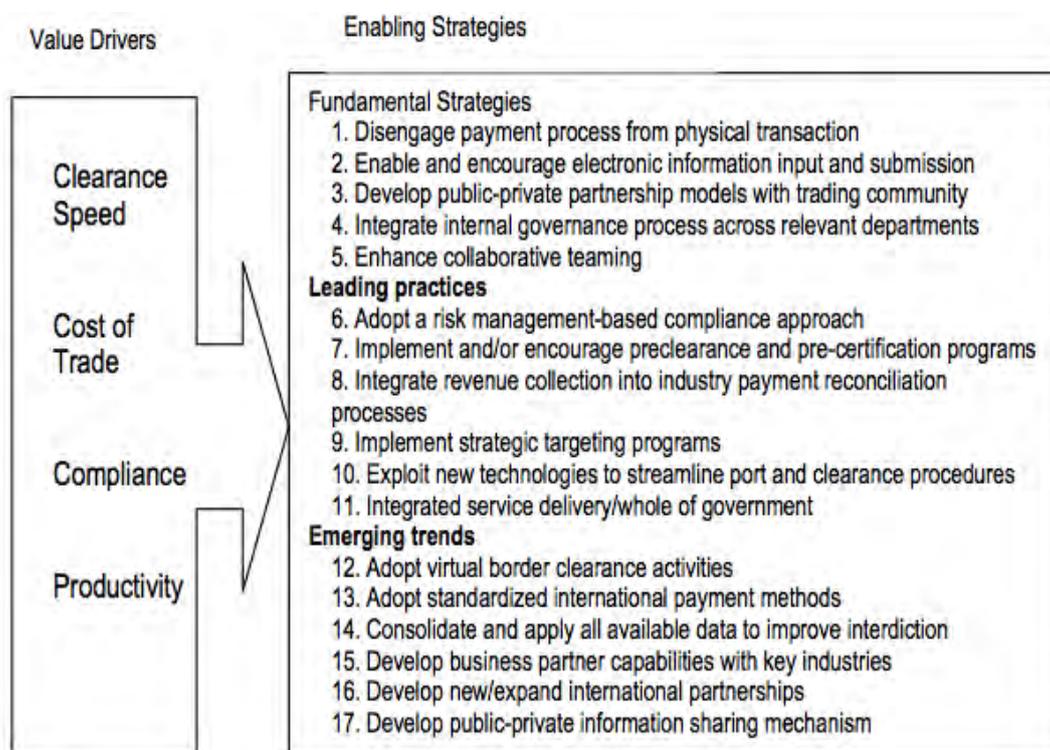
The most successful institutions and businesses around the world recognize that risks exist and attempt to manage or mitigate their risks. Risk can be defined as the chance of something happening that will have a negative impact on an organization’s objectives. In managing risk, a balance must be struck between costs and benefits, as clearly it will not be cost effective to address all risks equally. Criteria are needed to decide what constitutes an acceptable or unacceptable level of risk.

Risks are defined and measured relative to an organization’s objectives. When implementing a risk-based PCA program, it is critically important that customs take into consideration who its key stakeholders are, what key operational performance indicators exist, and the value drivers for implementing such a control. This approach reveals that if one were to consider the diverse interests of multiple stakeholders, then the trade-off between control and trade facilitation is not universally applicable. From a risk management perspective, clearance speed and compliance can be complementary and reinforcing, as illustrated below.

Trade facilitation for low-risk clients, which results in higher clearance speed and lower costs for such clients, supports compliance, a value driver closely associated with control, in high-risk areas by reallocating resources away from the low-risk areas to the higher-risk area. Such reallocation enhances productivity. Risk assessment determines who gets what kind of treatment.



The diagram below enumerates the strategies applicable to the respective value drivers.



Risk management within Customs can be strategic, operational or tactical:

- **Strategic risk management** - can include social issues (exclusion of drugs, pornography, etc.), import/export prohibitions and restrictions (e.g. CITES), public health, environment, commercial policy measures (e.g. IPR, GSP), quotas, and duty and tax issues. It is based on Customs being able to identify the overall risk posed by

an entire sector or a group of importers. In identifying this industrial sector, a customs administration will be able to target all or selected companies within the industry sector as high risk.

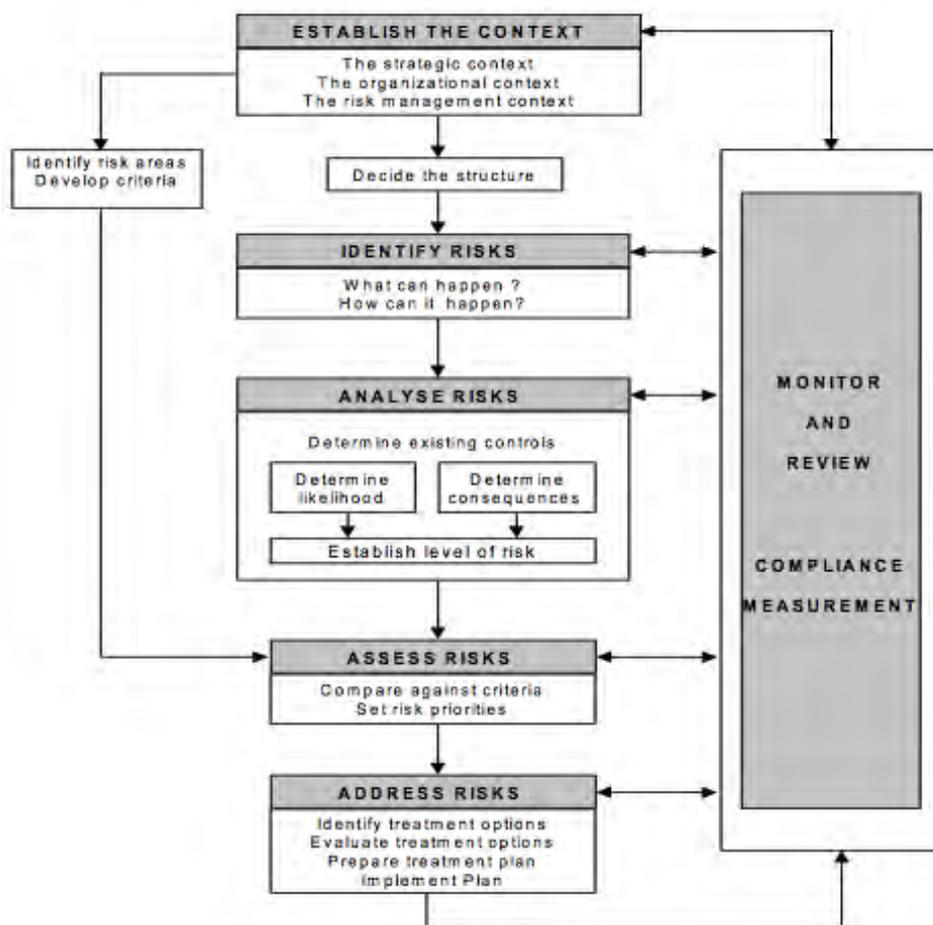
- **Operational risk management** - is the determination of the level of control necessary to deal effectively with the assessed risk. An example of this is determining the audit controls applied to an importer or how to deploy limited staff and equipment effectively. Using this approach, Customs moves from being a "gatekeeper" by checking every movement to checking only selected movements that demonstrate the greatest risk. It deals with specific import transactions. Factors to consider when identifying high risk transactions may include:
 - Who the importer is;
 - What commodity is involved;
 - Prior discrepancies or violations involving the commodity;
 - Major high value importation;
 - Country of origin;
 - Whether any special regulations or programs apply to this type of import (such as quotas); and,
 - Whether the value declared for the commodity is outside the previously established high-low range.
 - Other factors to consider include:
 - Referral information from other customs units;
 - Potential of revenue recovery;
 - Risk of revenue loss;
 - Government program priorities; or
 - Specific intelligence.
- **Tactical risk management** - is used by officers at their workplace in dealing with immediate situations. Using set procedures combined with intelligence, experience and skill, auditors decide which traders and transactions require a more in-depth audit. This is the process of identifying groups of high-risk transactions by particular importers. When identifying these groups of high-risk transactions, the auditor must review:
 - Importer's volume of imports;
 - Total value of imported goods;
 - Types of goods imported;
 - Prior importer or compliance problems; and
 - Whether it is a first time audited importer/exporter?

RISK MANAGEMENT CYCLE

The on-going process of risk management is actually a cycle of well-defined steps, which when taken in sequence, supports better audit decision making by analyzing risks and their

impact. While there are many risk management cycles espoused in both the public and private sectors around the world, they all espouse the following fundamental steps:

- Establish the risk management context;
- Identify the risks;
- Analyze the risks;
- Evaluate the risks;
- Address/Treat the risks; and
- Monitor and review the process through compliance measurement.

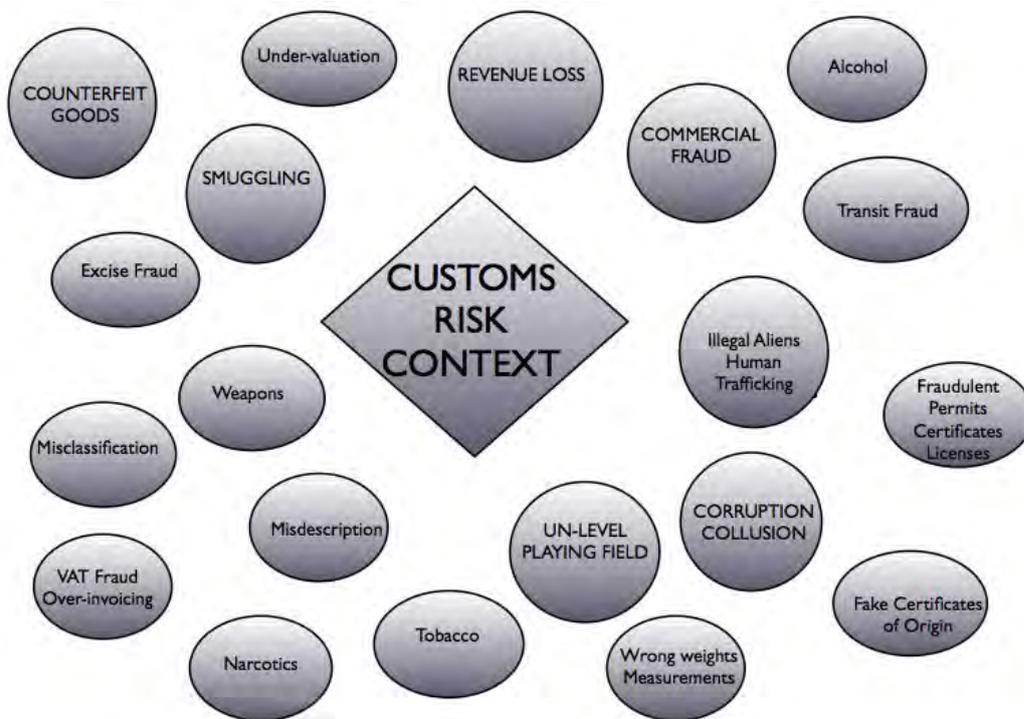


STEPS IN THE RISK MANAGEMENT CYCLE

1. Establish the Context	Identify and assess risk areas and criteria from three levels: - Strategic management vis-à-vis the goals of the bureau; - Operational management determines the level of control necessary to deal with assessed risk - Tactical management involves workplace situations
2. Identify risks	Based on strengths and weaknesses of participant, clients and stakeholders, identify risks for violations, where, when how risks are likely to be incurred
3. Analyze risks	- Determine controls and analyze risks in terms of likelihood and consequence. - Compliance measurement supports this function
4. Evaluate risks	-Compare risk estimates with established criteria in step 1. -Rank the risks to identify management priorities
5. Treat risks	- Decide on intervention measures appropriate to the risks
6. Monitor and Review	Monitor and review the performance, effectiveness and efficiency of the risk management system and changes which might affect it.

Each of these steps is discussed in detail below.

Establish the Context



It is critically important to identify the risk context in which PCA controls will be operating. To establish the context, it is important to clearly set out the mandate, goals, and objectives of Customs, as well as the scope, strategies, and parameters of Customs’ responsibilities and activities.

Examples of some of the overall mandates/objectives of Customs, which may be threatened by risks include:

- Protection of the environment
 - Import of restricted or prohibited goods without adequate/genuine authorization
 - Misdescription of goods
 - Misdeclaration
 - Failure to meet end-use requirements/diversion;
 - Misuse of goods
- Intellectual property rights infringement
 - Operators importing counterfeit goods at a significantly lower customs value than the genuine goods
 - Counterfeit goods may represent a significant public health and safety risk, e.g. counterfeit pharmaceuticals, automotive spare parts.
- Contraband
 - Prohibited or restricted goods being smuggled into a country causing public health, safety or other risks to society, e.g. smuggling of cigarettes, alcohol, narcotics, weapons and ammunition, pornography, hate literature, etc.
- Illegal aliens, human trafficking, terrorism
 - Illegal entry or smuggling of persons into a country
 - Corruption/collusion/bribery/forgery/internal conspiracy between economic operators and customs audit staff
 - If left unchecked, corruption can allow any of the above frauds to occur.
- Political Instability/Undue Influence
 - Politicians or senior officials using their positions to circumvent customs controls
 - One way of mitigating political risks is to secure an active role for customs in the policy decision-making process, e.g. if revenue is a high priority, it is important that customs participates in the process of setting revenue targets.
- Security
 - Concealment
 - Misdeclaration
 - Forgery
 - Dissimulation of origin or category of good
 - False identity
- Protection of Society
 - Prohibitions

- Goods below accepted standards and quality
- Counterfeit goods
- Regulation of foreign trade
 - Licenses
 - Quotas and contingents
 - Rules of origin
- Commercial Fraud and the Impact on Revenue Collection
 - Traders obtaining an unfair trading advantage, thereby injuring domestic industry and/or creating an un-level playing field in the marketplace, which causes a legitimate business to no longer be able to compete in the marketplace or creating an environment where investor confidence is eroded
 - *Under-valuation* - Fraudulent declaration of the customs value; incorrect or non-declaration of all elements to be included in the customs value, e.g. assists, commissions, research, specific freight and insurance charges
 - *Misclassification* - Goods being classified according to an incorrect tariff code which draws a lower rate of duty/tax
 - *Misdescription* - Goods being deliberately misdescribed or poorly described on the commercial invoice and other transport/trade documents such that they can be classified according to an incorrect *tariff code*
 - *Improper weights or measurements* - Goods being improperly measured to reduce duty/tax liabilities
 - *Transit fraud* - Goods being removed or substituted during a transit movement
 - *Origin fraud/false or fake certificates of origin* - Operators obtaining a preferential treatment for which the goods are not eligible
 - *Fraud related to duty deferral regimes* – Including:
 - Fraudulent claims for duty drawback and inward processing
 - Illegal removal of goods from a customs warehouse
 - Failure to re-export goods subject to temporary admission
 - *Excise Fraud* – Including:
 - Over-production of excisable goods
 - Improper use of band-rolls and tax stamps on packaging
 - Removal of excisable goods from a warehouse without customs authorization
 - *Fraudulent granting of duty/tax exemptions* - Consignments granted duty/tax exemption that do not meet exemption criteria, or goods not meeting end-use requirements to obtain an exemption
 - *VAT fraud* - Over-invoicing to inflate the value of goods and the amount of VAT payable on low-duty payable goods at the time of import, in order to

inflate the amount of VAT refund granted or to artificially inflate business expenses in an effort to reduce income tax liabilities

Identify the Risks



The purpose of this step is to identify all risks that affect customs daily work and may prevent RS Customs from reaching its objectives. When performing this step of the risk management cycle, it is important that inputs be received from all ranks, organizational units and physical locations where Customs operates. It is important to note that the perceived risks identified by customs in one country may differ completely from those in another country and that risks change over time. It is also important that the risk identification process be completely honest and open. There are no wrong answers here, since risk is largely a perception. Far too often, customs officers and/or management may feel they cannot speak the truth or at least speak openly given the political environment in the country or that exists within the customs administration (e.g. if it is government policy not to publicly admit that any problems or risks exist). What is important is that each potential risk is identified, then defined/explored in as much detail as possible, so that it will be possible to categorize and prioritize risks.

Risk indicators can be specific. These may include:

- Trader or economic operator e.g. importer, exporter, consignee, customs broker, freight forwarder, warehouse operator;
- Commodity code;
- Country of export/origin;

- Supplier, exporter or shipper;
- Carrier (airline, shipping line, or trucking company);
- Transport route (oil pipeline, particular flight number, vessel voyage, or truck plate number);
- Conveyance (ship, motor vehicle, aircraft or rail car);
- Category of users (first time importer or fly-by-night companies);
- Season or time period;
- Particular checkpoint;
- Particular express courier;
- Particular individual or driver;
- Goods subject to quota or some other trade preference;
- Goods potentially subject to CITES;
- Unusual transport route; and
- Specific principal, etc.

To identify risks, it is important to ask the following questions:

- What can happen?
- When can it happen?
- How can it happen?
- Why can it occur or what are the opportunities that allow it to happen?
- What weaknesses in customs procedures or controls allow this risk to occur/not be detected?
- What is the threat and scale of the impact from circumvention of customs laws?

The elements to help identify customs risks include:

- Performance of an industry or sector against customs legislative/administrative requirements;
- Relative performance of individual traders/operators within that sector;
- Establishing the existence and effectiveness of the trader's/operator's own internal control systems, e.g. whether there is a separation of duties/tasks;
- The results of any external audits of books, records and accounting systems;
- Identifying what, why and how risks can arise as a basis for further analysis; and
 - This step requires an in-depth description of the trader's current control processes. This includes interviewing the trader's staff to understand strengths and weaknesses in their books, records and control systems to learn:
 - The risk likely to be incurred and by whom;
 - The threats and their impact in case of circumvention; and

- How and why opportunities arise for fraud to occur.
- Obtaining intelligence information from the Risk Management Division to assist in identification of high-risk sectors, industries, importers, commodities and transactions.

Analyze the Risks



This step involves analyzing risks in terms of likelihood and consequence. The analysis should consider:

- How likely is a risk event likely to happen?
- What are the probability and/or frequency that a risk may occur?
- What are the chances of this happening?
- Has it happened before (in the country or elsewhere)?
- Is it realistic or simply a projection?
- How would the trader/operator carry out a fraud along these lines?
- What would be the necessary resources to make the risk come true?
- What is the potential magnitude of consequences (outcome of an event) in light of existing controls?

By looking at all these elements, the post-clearance auditor should be able to produce an estimated level of risk and take a decision whether the risk is acceptable or unacceptable. If the estimated level of risk is low, then the risk may fall into an acceptable category and no further action may not be needed. If the estimated level of risk is sufficiently high, then a decision must be taken on the priority of the risk to determine which risk will be treated first.

Evaluate Risks

The next step is to compare estimated levels of risk against the pre-established criteria. Risks need to be evaluated and ranked against management priorities. There are different types of ranking systems. The assessment into high, medium, and low is widespread. In complex environments, a more detailed system of ranking may be needed, such as a range from one to 100. The latter also requires the determination of high and low risks but allows for more precision. Risks must be continually monitored for any change in their nature, level or significance. The table below charts the appropriate treatment choices corresponding to levels of likelihood and impact of risks:

IMPACT	LIKELIHOOD		
	Low	Medium	High
Significant	Considerable management required	Must Manage and Monitor	Extensive Management Essential
Moderate	Risks may be worth accepting with monitoring	Management effort worthwhile	Management Effort Required
Minor	Accept risks	Accept but monitor risks	Manage and monitor risks

Source: The Integrated Risk Management Framework, Treasury Board, Canada

Treat Risks

Once risks have been assessed and given a priority, each risk needs to be treated. Within the context of PCA, this involved establishing parameters for the audit itself. Normally this involves the following steps:

Drawing/Designing Risk Profiles

This includes the following tasks:

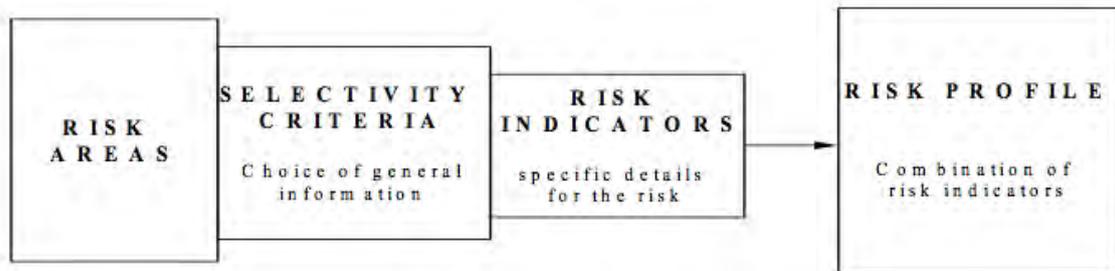
- **Relate the risk elements to customs declaration data.** The standard declaration for a Single Administrative Document (SAD) has 54 fields, each one describing an element of the transaction, its participants, and its financial aspects. The issue is to relate the risks to one or several of the fields. Usually, each risk would be included in a combination of fields when these reach certain values. For example, if newly established importers are considered a risk, the identification number of the importer would be matched against the importers' file and companies registered less than one year ago would be considered high risk.
- **Examine supporting transport and commercial trade documents.** Transit carriers' documentation, manifest, bill of lading, air waybills etc. are normally attached to the declaration, and can be computerized/available in ASYCUDA. Such

data provides additional information on the international transaction. For example, indirect routes could point out the likelihood of en-route manipulation of the cargo.

- **Draw patterns.** Using past detection cases, the auditor should develop specific patterns of fraud, starting by the combination importer, classification code, country of origin, and then progressively refining it.
- **Anticipate.** Using the “what if?” approach, the auditor should identify the tariff headings or countries of origin under which potential offenders would try to dissimulate their imports. In particular, this is the case when there are two different tariff headings, with different rates of duty for relatively similar commodities and a closer scrutiny is necessary to establish their classification. The same can apply to two different origins. Some countries use the notion of “risk countries” to set their risk profiles. Often they designate shipments from a particular country as high-risk. This is not necessarily a good approach, as it results in overwhelming their examination facilities and is not a good use of risk management principles. Importers will also probably declare another origin to avoid control. In any case, the system encourages them to do so. Obviously, country of origin should be considered, but it is only one element of the composite.
- **Include commercial intelligence.** This involves the identification of major importers, in terms of revenue, imported commodities and number of commodities. It is also important to obtain all offense reports. It also means drawing a list of the most frequently counterfeited or smuggled commodities by tariff items and listing them by importers. Using records of past imports, the auditor should identify whatever does not fit usual patterns (e.g., infrequent importers, imports inconsistent with the importer’s usual activities, etc.).
- **Establish and maintain a database record of all high risk importers and exporters, freight forwarders, brokers, transport companies, with a ranking of their compliance** (using past records and cross-checking with the tax administration, or other relevant agencies).
- **Develop risk profiles.** Risk profiling is the means by which Customs puts risk management into practice. It replaces random examination of documents and goods with a planned and targeted working method, making maximum use of customs resources. A risk profile is a document that can be set out in a number of ways, but it should be comprehensive and relevant to the traffic throughput in a customs office. The risk profile should contain a description of the risk area, an assessment of the risk, the counter-measures to be taken, an action date, the results and an evaluation of the effectiveness of the action taken. A risk profile can be kept in a binder or on a local computer and it should be as accessible as possible to customs officers. Once established, the profiles along with other information and intelligence will provide a basis for targeting potentially high-risk traders/operators for audit. The Post-Clearance Audit Division needs to develop its own risk profiles in a format compatible with customs processing. Suggested profiles from other RS departments and from other outside agencies should also be considered. An MOU may be necessary in this regard.
 - Risk profiles should be in a form that will enable easy computerized processing as imports take place. They should therefore be codified according to declaration data format (essentially, origin, classification and identification of operators), and include a data range within which the profile will be active (for example, only certain categories of imports under a certain value shall be activated). The profile should indicate: description, period of

validity, data range, date and additional comments. Risk profiles are too general if they are too broad and all encompassing, e.g. apply to all imports from one country or group of countries or all imports of one commodity.

- **Develop Selectivity Criteria.** This is the process of determining whether a particular trader/operator or transaction needs to be looked at more closely. In an automated environment, four selectivity filters can be applied, namely international, national and local profiles and a random selection system. The first two of these are based on a system of profiles built up from the (international) customs knowledge base and by using data analysis systems to assess the risk of loss and non-compliance. Artificial intelligence and expert systems such as pattern recognition can be of great help in supporting risk assessment and profiling policy. The officer should be aware that, when building up a set of profiles, the system should be flexible and capable of handling not only simple individual data elements, but relatively complicated combinations of data elements as well. Using combinations allows Customs to fine-tune its targeting capabilities. For example, Customs might only want to select a particular commodity if it comes from a particular country and not if it comes from any other country. The principal difference between international/national and local profiling is that international/national profiles are mandatory for all customs offices whereas local profiles only concern a single customs office or a small group of offices. However, information from local profiles should be used as part of the general risk analysis, and where appropriate, upgraded to national status. All profiles should be reviewed on a regular basis. For security purposes, steps should be taken to identify those officers authorized to change profiles at both levels. A random selection algorithm can also be used to select a declaration for post-auditing by Customs.
- **Target Selectivity Criteria.** The development of specific selectivity criteria is an integral part of risk management. Far too often, customs administrations jump to establishing criteria without having followed the whole risk management cycle. When this occurs, normally, the criteria are faulty and ineffective. Selectivity criteria for dutiable goods may include the history of the importer/exporter/carrier/agent/etc., the origin and routing of the goods, and prohibitions or restrictions. The WCO Manual on Risk Assessment, Profiling and Targeting and the WCO Handbook on Container Control provide significant detail regarding risk indicators and selectivity criteria for consideration to redress each risk profile. Risk indicators are specified selectivity criteria such as specific commodity code, country of origin, country whence consigned, licensing indicator, value, trader, level of compliance, type of means of transport, purpose of the stay in the customs territory, financial consequences, or financial situation of the trader/person.



- Quota	- kind of goods	- textiles under quota	textiles under quota AND/OR
- GSP	- country of origin	- specific country of origin	specific country of origin AND/OR
- CITES	- transport route	- unusual transport route	unusual transport route AND/OR
- Trader	- principal	- specific principal	specific principal
- etc.	- etc.	- etc.	

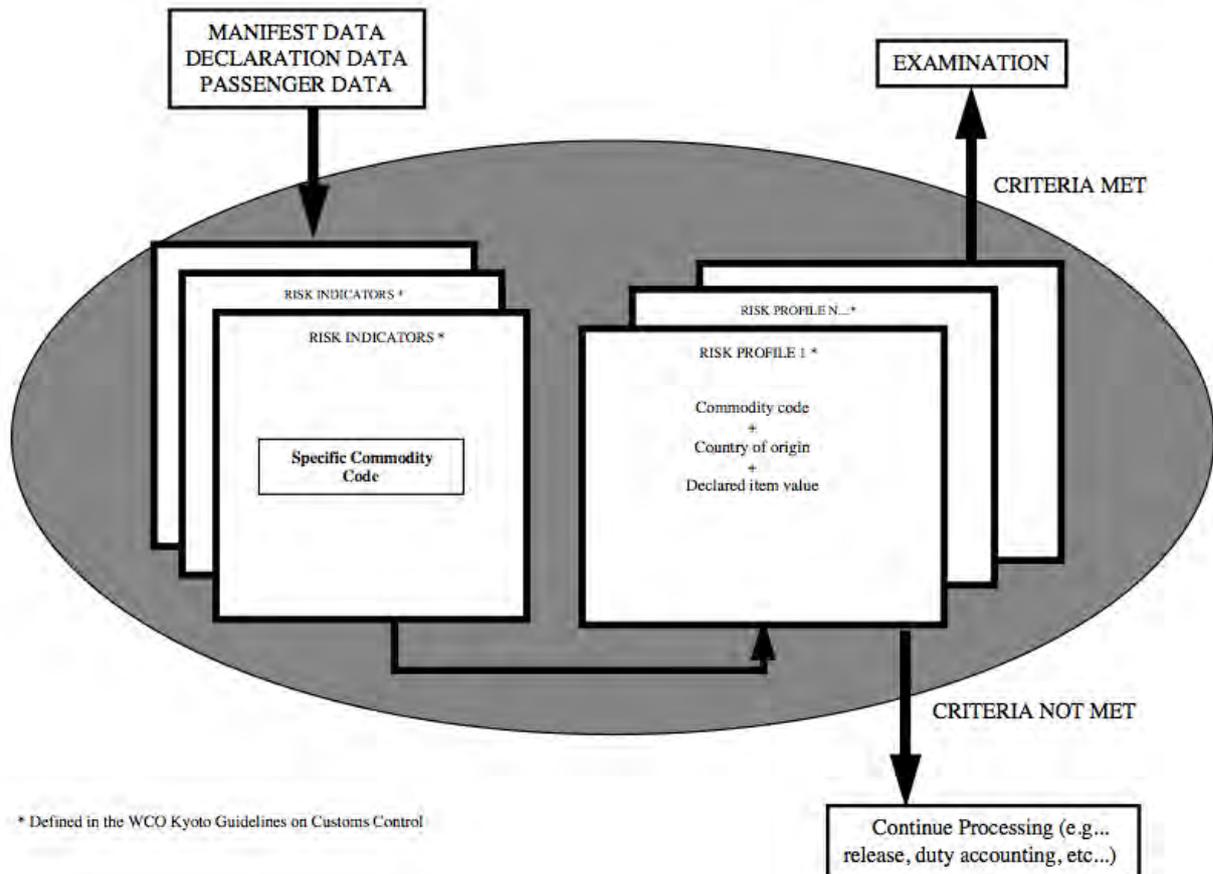
The ASYCUDA system allows Customs to subject declarations to a series of selectivity filters to determine which declarations may require further examination. Such a system may direct claims to different routes. Four selectivity filters can be applied, namely international, national, regional and local profiles, as well as a random selection system. The first two of these are based on a system of profiles that are built up from the knowledge base of (international) Customs and from utilizing data analysis systems, which assess the risk of loss and non-compliance. Artificial intelligence and expert systems such as pattern recognition systems will be of great help to support risk assessment and a profiling policy. When building up a set of profiles, the designer should be aware that the system needs to be flexible and capable of handling relatively complicated combinations of data elements as well as simple single-data elements. Using combinations allows Customs to fine-tune its targeting capabilities. For, Customs might only want to select a particular commodity if it comes from a particular country and not if it comes from any other country.

The principal difference between national and local profiling is that national profiles are mandatory for all customs offices, while local profiles only affect a group, or a single customs office. However, information from the local profiles should be used as part of the general risk analysis, and where relevant, upgraded to national status. All profiles should be reviewed on a regular basis. Security measures related to who can change profiles at both levels needs to be established. The random selection system uses an algorithm to select a declaration for further examination by Customs.

Another important element in the system design is to ensure that the coordinated interaction between the three levels of selectivity is monitored so that the overall target for examinations is not exceeded. The system will also have to be designed to ensure all data goes through the national profiles, while only the declaration data relevant to a specific region or customs office goes through the local profiles for that region or office. Facilities are often included to

allow profiles to be switched off temporarily by authorized managers.

Selectivity profiles are only as good as the information they contain. Regular review of profiles will tell customs officials which data elements and combinations of data elements have successfully detected non-compliant declarations. Analysis of the declaration information itself will also present clues to trends and identify potentially high-risk consignments.



Test and Evaluate the Effectiveness of Risk Profiles and Selectivity Criteria - Run the draft profiles against the database.

The computer system should produce a list of all declarations picked up under the risk profiles. The results should be analyzed and adjustments made accordingly. Results should be evaluated and adjustments to the risk profiles made. A random element of selection should always be used, either at the overall selection level or at risk profile level to validate risk profiles in order to introduce an element of uncertainty, prevent “reverse engineering” from importers, who may promptly detect the risk criteria in use and test compliant commodities and importers.

Monitor and Review

It is critically important to monitor and review the performance, effectiveness and efficiency of the PCA risk management system and to make timely changes that might affect it. This

monitoring and review is a continuous process and an integral step in the process of managing risk. All steps of the cycle must be monitored and reviewed to:

- Determine if risks previously identified are current and if new risks have emerged, as few risks remain static
- Re-evaluate the levels of risk assigned previously in the light of recent risk address activity; and
- Evaluate the effectiveness of compliance activity undertaken.

The monitoring and review process should include:

- *Risk Register* - Risks must be continually monitored for any change in their nature, level or significance and the process of changes properly documented. The risk register:
 - Details the rationale behind selecting the risks
 - Records the assumptions on which assessments have been made; and
 - Establishes an audit trail that ensures important information is not lost.
- *Audit Reporting* - The auditor must maintain close contact with his supervisor from the stage of preparing the audit planning through the closure of the audit, including the final audit report.
- *Legal Advice* - If during the course of the audit, issues arise which may require further legal interpretation, the post-clearance auditor must be allowed seek internal advice from the legal department.

In case a significant misrepresentation or potential customs offense is discovered during the course of the audit, the audit team should communicate and coordinate with the appropriate enforcement unit who will decide whether to start a formal investigation.

Compliance Measurement

Many customs administrations have instituted a modern and philosophical approach to their mission, which specifies that their ultimate goal is to achieve compliance. The measure of success is for their traders and for the imported and exported goods to be in full compliance with trade laws. Many Customs have also instituted a program of “informed compliance,” wherein their officers assist traders and industries to understand and apply the trade rules and to improve their internal company procedures to comply with import and export requirements. “Compliance measurement” is a phrase used when statistically valid random sampling techniques are used to determine the degree to which traders, carriers, imported goods, etc. conform to customs rules and procedures. When designed in a systematic and appropriate manner, compliance measurement methodologies provide objective and statistically valid results. Compliance measurement can be used as a diagnostic tool to identify areas of non-compliance.

Compliance measurement as a diagnostic tool for customs administrations should be used in conjunction with risk assessment, profiling and other targeting procedures. Used strategically, compliance measurement and targeting can provide the necessary balance to focus resources effectively in areas of concern to Customs. In addition, results of initial compliance measurements can provide important information to enhance risk assessment

methodologies. It provides a basis for customs PCA management to assess its own performance for revenue protection and enforcement of laws, to improve its efficiency and effectiveness and to develop strategies to improve compliance. Compliance measurement may highlight:

- Areas where there are weaknesses in customs procedures and controls;
- Areas where additional revenue may be lost;
- Weaknesses in transport-related customs controls;
- Public health and safety issues; and
- IPR enforcement issues, etc.

It is important that issues discovered during the audit be brought to the attention of the responsible management so that corrective action is taken to reduce or mitigate the risk in the future. The compliance measurement process can also be carried out through external government audits by statutory audit authorities, such as the Comptroller or Auditor General. Although the scope and methodologies of these reviews differ, their objective is to identify weaknesses in the audit control program and to make recommendations for improvement. The results of these measurements can help direct resources effectively. In determining compliance rates for individual importers, those found to have high compliance rates may have their goods examined less frequently, while those having low compliance rates might have their goods examined more frequently. The findings of compliance reviews for commodities, traders and industries provide information to update the existing selectivity criteria used to target high-risk transactions, as well as the overall effectiveness of an administration's risk management program. In addition, they contribute significantly toward determining trends and issues relating to specific industry sectors. The result should be that focused, up-to-the-minute analytical information is available to assist customs officers in their daily activities.

Recommendations: The RS should implement the WCO-recommended Risk Management Life Cycle to support effective implementation of risk-based PCA controls. This cycle should consist of the following formal steps:

- Establishing the risk management context;
- Identifying the risks;
- Analyzing the risks;
- Evaluating the risks;
- Addressing/Treating the risks; and
- Monitoring and reviewing the process through compliance measurement.

Technical assistance and training is required to support implementation of Risk Management.

INTERNATIONAL BEST PRACTICE FOR CUSTOMS POST CLEARANCE AUDIT

ATTRIBUTES FOR SUCCESSFUL TRANSITION TO PCA

There needs to be a philosophical and operational shift from the traditional approach of checking individual declarations on a transaction-by-transaction basis, to a risk-based audit process whereby particular high-risk industries/sectors as a whole are identified, particular high-risk firms within that sector are identified, and then selective high-risk transactions by the targeted firm are audited.

Normally, a progressive audit strategy is employed whereby the audit begins with a desk audit of selected transactions, with the trader given an opportunity to provide additional requested information by Customs. Based on the results of this initial desk audit, a decision will be taken whether or not to proceed with a field audit and:

- Ensuring that the organizational structure of the Post-Clearance Audit Division has some degree of sector/industry specialization.
- Having an effective mechanism for reporting audit results, measuring trader's compliance, and monitoring that any deficiencies identified during the audit are corrected by the trader within prescribed timeframes.
- Making maximum use of data mining of the customs declaration database and refining automated selectivity criteria in order to select high-risk traders/operators and transactions to be audited.
- Making sure that auditors have access to intelligence databases to support identification of high-risk firms having histories of non-compliance.
- Ensuring that the audit risk management process has effective intelligence feedback mechanisms from declaration verifications, cargo inspections, and external sources.
- Putting in place measures to strengthen auditor integrity and accountability.
- Ensuring that stakeholders are appropriately advised of the role and operation of the customs PCA control, including their rights and obligations, so as to ensure that there is collaboration and cooperation between customs and stakeholders.

TYPES OF PCA

The PCA's can be categorized into the following three types.

Transaction/Paper-based Desk Audit

Within a prescribed period, after acceptance of import declaration (normally 90 days), Customs selectively examines, on a case-by-case basis, import declarations for correctness of payment of duties and taxes. Normally, declarations are automatically selected using risk management techniques. The auditor may request the trader to submit supporting information/documents or may seek the assistance of the customs service in the country of export in order to compare export declaration data against import declaration data.

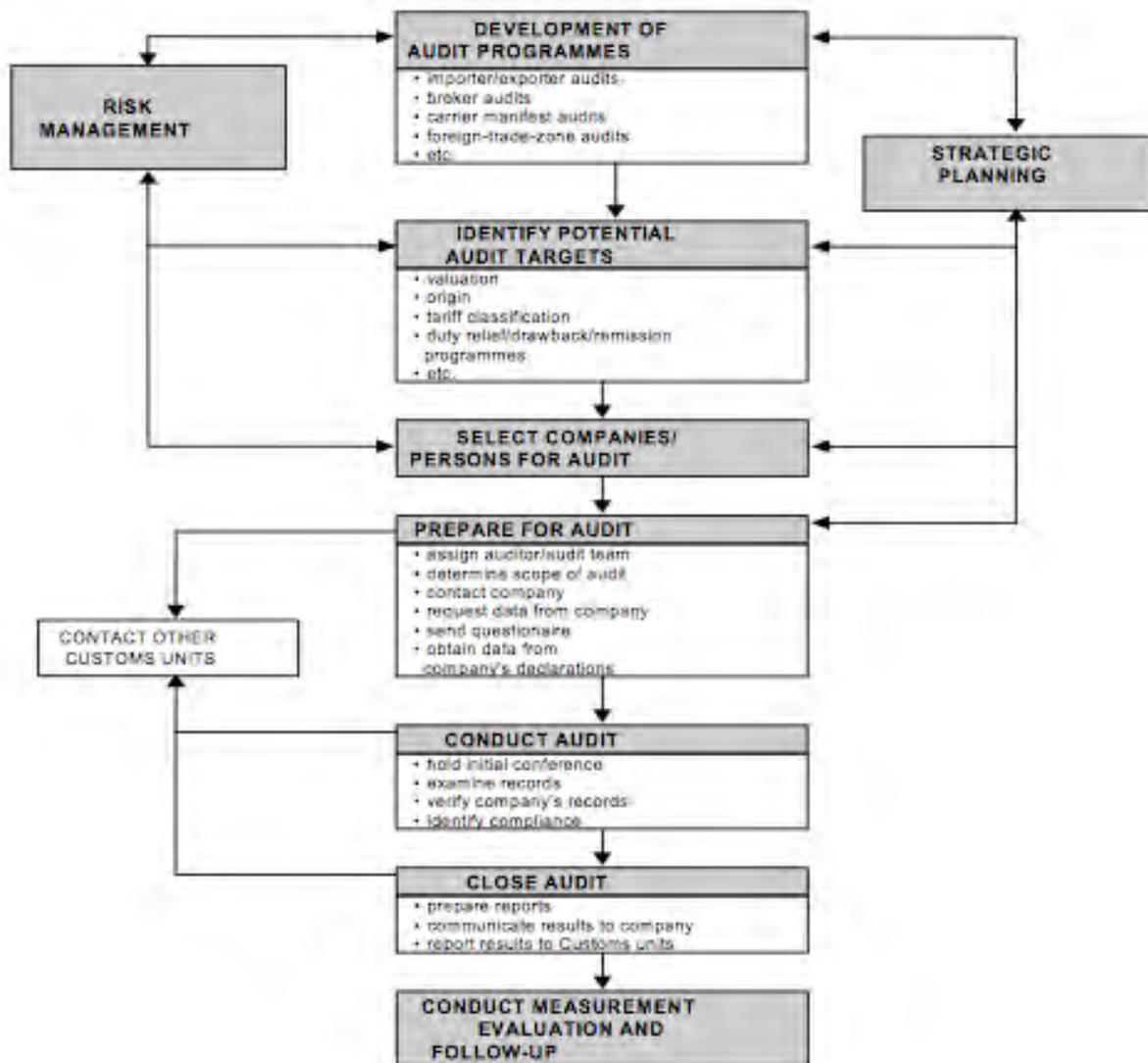
Field Audit

This type of audit examines for a particular high-risk industry/sector, a particular trader/operator's import transaction patterns and items considered a high risk of tax evasion. Normally, the field audit commences with a selective check of specific transactions, followed by a field audit of the trader's books, records and systems carried out at the trader/operator's premises/offices where deemed necessary.

Self-assessment Audit

Import cases that customs auditors have selected as “audit subjects” are self-examined by those selected companies. This is a self-assessment audit system conducted by the selected companies. Import cases that customs officials have selected as “audit subjects” are self-examined by those selected companies. Self-assessment means an audit system where importers themselves check the appropriateness and correctness of their customs duties and taxes paid, and the legitimacy of customs clearance in compliance with procedures by customs regulations. Under the system, the selected company reports the outcome of the self-assessment to Customs. If an incorrect or unfaithful self-assessment report is made to Customs, Customs has the authority to conduct a paper-based or on-the-location audit and can cancel the self-assessment status of the selected company.

INTERNATIONAL BEST PRACTICE STEPS TO CONDUCT A PCA



Develop Audit Program/Plan

The Post-Clearance Audit Division should develop an annual audit plan at the beginning of each year. This plan should:

- Be prepared taking into account the RS Strategic Plan;
- Be based on specific audit coverage, i.e. based on the specific customs regimes or industrial sectors on which the division plans to focus its audits. These targeted risk regimes or industrial sectors should be identified through conduct of a risk management cycle;
- Identify:
 - Specific high-risk sectors or industries and high-risk importers/traders within that sector
 - Specific high-risk commodities
 - Specific high-risk countries of origin
 - Specific high-risk suppliers; and
 - High risk transactions having declared values outside accepted norms, etc.;
- Reflect existing or planned audit resources available to ensure that the number of audits being planned is realistic given the number of audits in progress and additional audits planned during the year. To do this, each planned audit could be assigned standard hours for completion. Each available auditor or audit team hour should then be calculated in order to determine how many audits could be effectively performed by each auditor or audit team during a given year. Alternatively, each stage of an audit activity may be broken down into time blocks in order to measure productivity against time spent. Either method allows Customs to allocate its scarce auditor resources effectively and efficiently;
- Set out specific audit objectives and key performance indicators (i.e. reasons for conducting these audits and expected outcomes);
- Be broken down further to 12 monthly work plans; and
- Set out the modalities for conducting audits, i.e. estimates of how many desk audits and how many field audits will be conducted.

Identify and Select Potential Traders/Operators to Audit

The selection of potential traders/operators for a compliance verification audit should be based on risk profiles. Audits should generally be conducted in the customs risk areas of valuation, origin, tariff classification and duty relief programs including drawback, remission, exemption, and VAT refunds.

Audit Case Selection

- Risk-based
 - High-risk: Fraudulent intent and/or habitual.
 - Medium-risk: Occasional, non-intentional, and more issue-based.
 - Low-risk: Generally conforming and reliable.
 - Random Selection: To check integrity of selection parameters.
 - Emergency Cases: Through local knowledge and spontaneous threats to compliance.

- Audit targets
 - Importers: Home use; warehouse; exempt/preferential
 - Exporters: Re-exporters; other
 - Brokers/clearing agents
 - Warehouse keepers
 - Transporters

Depending on the profile of the trader/operator to be audited and the turnover of its business, customs PCA's may be conducted on a:

- *Continuous basis*. For example, large automotive manufacturing companies operating in many countries are audited continuously in many countries given their turnover, scale of import/exports and clearance benefits received.
- *Cyclical basis*. For example, some large, high turnover trading companies are audited each year during the same period to coincide with the completion of their year-end reporting).
- *Occasional basis*. For example, firms should be audited at least once every 3 years.

The selection of potential traders/operators for audit should take into account such risk factors as:

- Size/turnover of company;
- Volume of trade (e.g. the percentage of the entire sector that the firm represents may be considered);
- Value of imports;
- Value of exports;
- Industry type;
- Whether duty deferral regimes are used;
- Type of goods imported;
- Range of tariff classification codes used and the rate of duty/tax applicable (e.g. whether goods have tariff classifications with end-use provisions);
- Goods drawing high rates of duty/tax;
- Goods where tariff classification can be misinterpreted;
- Past history of the company (e.g. any previous customs or tax enforcement actions taken);
- Intelligence received;
- Trade trends;
- Intelligence/referral information from other enforcement units (e.g. Fiscal Investigation Unit or Police)
- Number of cargo inspections undertaken during a period;

- Cargo inspection feedback results;
- Reassessments by commodity specialists (i.e. Monitoring and Expertise Unit);
- Intelligence/referrals from other revenue agencies/neighboring customs services;
- Origin of goods;
- Known high risk exporters/suppliers;
- Potential for duty/revenue recovery;
- Risk of revenue loss; and
- Government program priorities.

GOLD LIST Companies

Certainly, this group of approximately 165 firms that were never subject to a compliance audit before being granted expedited clearance procedures and cargo inspection rates at or below 1% must be considered high-risk and a priority compliance audit target group. An analysis could be undertaken using the foregoing criteria to determine the priority that each Gold List firm should undergo a compliance audit.

Prepare for Audit

Once a trader/operator has been selected for an audit, the manager/head of the Post-Clearance Audit Division should assign the auditor or audit team to conduct an audit. While a desk audit can be conducted by a single auditor, normally field audits require at least two auditors to be present. Once assigned, the first task of the auditor/audit team is to prepare an audit plan for that company, including the planned audit scope, audit methods and expected duration.

The following steps are normally involved in preparing for the PCA:

- Initial Audit Conference/Contact:
 - *Initial Letter to Auditee*: Auditor should write/send a letter in advance to auditee, including:
 - Proposed period to be audited;
 - Proposed date of the initial meeting with auditee;
 - Names of personnel who will carry out the audit;
 - Assurance of confidentiality;
 - Any other relevant documents, books and records relating to the audit period required by the auditor for verification; and
 - Request focal contact point in auditee's company.
 - *Initial Meeting with Auditee*: After dates for the audit have been agreed upon, an initial audit conference is essential. The meeting should include:
 - Customs PCA team (i.e. team leader and members);
 - Senior member(s) of the company to be audited, which helps ensure a high level of cooperation; and
 - Consultants, accountants or lawyers may attend.

- The auditors should:
 - Introduce and identify themselves to the relevant personnel and including contact details;
 - Explain the purpose of the audit;
 - Explain why the company is being audited;
 - Explain the broad method of the audit – that is, a combination of system-based, statistical and selected transaction checking coupled with physical inspection aimed at identifying the overall degree of compliance with revenue requirements;
 - Mention the estimated duration of the audit (i.e. an estimate, subject to the ease of access to all relevant records, which may of course change if discrepancies or irregularities are identified);
 - Request that an official or team from the company be made available at all times to answer any questions that may arise;
 - Mention the fact that the Financial Controller may be required if there are valuation/payments issues; and
 - Verify that the trader is in possession of all the supporting documents requested in the letter of notification.
- The auditee has a stake in acquiring and maintaining customs facilitation, and therefore, has a responsibility to ensure that the audit is carried out in a professional manner. Representation by a senior member of the company is invaluable to ensure a high level of cooperation.
- *Audit Coordination and Communication:* From pre-audit planning to completion, it is essential to maintain communication and coordination with the auditee and with other interested parties in Customs. The auditee should be kept fully informed of any potential findings or other relevant customs matters throughout the audit.
- *Audit Contact:* At the initial audit conference, the auditee should be asked to designate a representative to whom all requests for the production of documents (books, records, etc.) should be directed.
- *Pre-Audit Survey:* Auditor/audit team should conduct a preliminary examination of the auditee. The objective of the survey is to focus on specific risk areas of an auditee's import declarations, through analysis of available data, and to draft an audit plan that includes audit scope, audit methods, and assignment of the auditor/audit team.
- *Auditee Self-Assessment:* The auditee may be asked to fill out a questionnaire to obtain information about its structure, related-party transactions, commodities, methods of payment, valuation, manufacturing costs, sourcing and supply. In related-party transactions, the foreign parent company may also be asked to complete a questionnaire focusing on information regarding the relationship between the auditee and its parent company.
- *Pre-audit Questionnaire:* This pre-audit survey/questionnaire is an examination of the auditee's company profile and/or transaction profile. This survey may include an evaluation of the strength and weaknesses within the auditee's commercial systems. Depending upon the size and location of the company to be audited, Customs may send out a background questionnaire to be completed by the company. Alternatively, the RS may send an auditor to the company to assist the auditee in completing the

questionnaire. Completion of such a questionnaire by the foreign parent company is normally voluntary.

- *Auditee Company Profile:* The pre-audit survey should collect the following information (wherever possible, data should be collected from databases available in Customs, with any remaining/missing information obtained from the auditee):
 - Full name
 - Tax Identification number
 - Address: physical, postal, manufacturing and Head office/branches
 - Organizational form (form of business entity, capital, shareholders, directors, business items, business (accounting) year, etc.)
 - Organization structure: units involved in customs work
 - Accounting system
 - Names of suppliers
 - Names of customs brokers/clearing agents
 - Business performance
 - Summary data of trade transactions
 - Total volume of trade;
 - Value of imports/exports
 - Number of declarations
 - Types of goods imported and/or exported
 - Import/Export restrictions
 - Content of import restriction involved in imported goods, if any
 - Whether any special regulations apply
 - Content of export restriction in export country, if any
 - Major items' shipping point, total amount and quantity
 - Existence of transactions between related parties (Note: the foreign parent company may also be asked to complete a questionnaire focusing on information regarding the relationship between the auditee and its parent company);
 - Records of export transactions
 - Past audit records
 - Past offense records – Prior import or compliance problems highlighted from Income Tax, VAT or Investigations sections
 - Content of internal/external intelligence
- *Auditee Transaction Profile:*
 - Price;
 - Price-related terms (price, delivery and payment);

- Amount of freight and insurance, and payees;
 - Fluctuation in declared value;
 - Comparison with values of identical or similar goods(if any);
 - Foreign and domestic market price and resale profit ratio (if any);
 - Application of valuation declaration and its contents;
 - Commodity information;
 - Methods of payment;
 - Value of commodities;
 - Costs associated with commodities;
 - Manufacturing costs, sourcing and supply;
 - Detailed product-cost information/submissions for analysis;
 - Related-party transactions; and,
 - Record-keeping systems.
- *Confidentiality of Information:* All of the above information may be commercially sensitive and should therefore, as with other information passed to Customs, be treated as confidential.

Conduct Audit

Internal Auditee Review

The Post-Clearance Audit Division should encourage the auditee, wherever practical, to carry out its own preliminary self-evaluation, review and analysis of its operations in relation to the upcoming PCA.

PCA

The auditor/audit team needs to analyze the trader's import/export declaration transactions over the determined audit period to decide which transactions represent the highest risk and should therefore be audited/verified.

The auditor normally undertakes a desk audit of selected transactions before deciding whether to initiate a field audit. The desk audit commences when the auditor requests from the trader specific additional detailed information, records and documents related to those specific trade transactions selected for audit. This formal request is normally a standardized letter of request on RS/Customs Administration's letterhead, stating the purpose of the audit, the transaction reference numbers and dates, the auditor's authorities and time period to receive a response and a checklist of specific documents requested.

Examples of documents that may be requested include:

- Commercial invoices;
- Shipping records;
- Purchase orders;

- Delivery notes;
- Accounts;
- Records;
- Contracts;
- Price lists;
- Catalogues;
- Royalty and marketing agreements;
- Inventory records;
- Journals;
- Ledgers;
- Bills of sale;
- Sales contracts;
- Business correspondence; and
- Records of payments (e.g. evidence of bank funds transfer or payment receipts; letters of credit, etc.).

The auditor may request assistance and/or supporting trade and financial documentation of other customs units, fiscal investigation units, police, or other customs services where the RS has a mutual administrative assistance agreement. Foreign customs services may be asked to provide/forward copies of export declarations, supporting invoices and copies of bank transfers made to the foreign supplier.

The auditee should be kept fully informed of any potential findings or other relevant Customs matters throughout the audit.

If an unintentional revenue shortfall is identified, the auditor should prepare a notice of reassessment to recover the shortfall and any applicable interest.

If fraud or significant misrepresentation or potential customs offense is detected, auditors should immediately inform supervisors for a decision whether to stop the audit and refer the matter to the appropriate enforcement unit who will decide whether to start a formal investigation that may lead to prosecution.

Close Audit

Exit conference/meeting

A formal meeting should be held with the auditee to present the audit findings and conclusions and to provide an opportunity for the auditee to give any explanations needed to assist preparation of the final report.

The exit conference should:

- Present observations on the reliability of the company's control systems in relation to compliance with customs laws and regulations;

- Outline areas causing non-compliance and recommend specific actions to remedy them;
- Provide an opportunity for the auditee to give any explanations needed to assist preparation of the final report;
- Inform the auditee that the meeting is to convey the results of the audit and will be followed by a written report;
- Inform the auditee that the results apply only to the period audited and that the RS may audit other periods subsequently;
- Inform the auditee that where documents/samples have been taken for verification, the audit may be re-opened;
- Convey that where follow-up visits to warehouse tenants are to take place, the outcome of the audits is contingent on satisfactory results from these visits;
- Inform the auditee that he may be liable for repeat audits at any time in the future;
- Discuss errors found arising from misdeclarations, misclassification, valuation, origin, procedural issues or other infringements;
- Discuss patterns and recommend necessary actions to avoid repetition;
- Set out liabilities and/or refunds due;
- Discuss details of both overpayments and underpayments and the relevant computation presented at the final meeting;
- Show the auditee the basis for the error and any steps needed to ensure that the problem is rectified;
- Reach agreement with the auditee on a timetable for remedial implementation; and
- Request that the auditee reply in writing within the time set by the laws and regulations, indicating:
 - Any objections to the findings/ recommendations of the audit; and
 - The actions management has taken or intends to take, as a result of the audit.

Final Audit Report/File

The Post-Clearance Audit Division should prepare a final audit report/file. All audit activities should be thoroughly recorded to allow compilation of a comprehensive report that clearly shows the steps taken during the audit. This report should be reviewed and approved by division management before a copy is sent to the auditee (provided the law provides for such a copy to be given to the auditee). A copy should also be sent to the appropriate customs office for resolution of any issue that has arisen. A report should be produced to ensure that all findings and other relevant issues are fully shared and discussed. Subject to national and international laws on confidentiality, the Customs Administration may share information on the outcome of the audit with other foreign revenue/tax agencies.

The Final Audit Report should include:

- A table of contents that is updated throughout the audit until finalization;
- Audit scope;

- Objectives and methodology;
- Significant findings and conclusions;
- Opinion on auditee's compliance with customs laws and regulations;
- Suggested corrective measures;
- Sufficient, competent and relevant information to allow for full understanding of the findings presented;
- Copies to the responsible customs offices and units for the settlement of any issue that has arisen;
- Dates of visit;
- Name and position in company of person(s) interviewed;
- Company status;
- Legal form (e.g. incorporated company, partnership, single ownership, etc.);
- Capital, held by whom;
- List of related persons;
- List of buyers who import similar goods;
- Confirmation that the signature on the value declaration was made by an officer or agent of the company, and that the signatory was in full possession of the facts and entitled to sign the forms;
- Principal types of goods imported (branded articles, raw materials, etc.);
- Countries from which the goods are imported;
- Purposes for which the goods are imported (e.g. own use, stock, further manufacture, resale as imported, etc.);
- Importer's function/occupation (e.g. manufacture, distributor, buying or selling agent, distribution or stock agent, broker, etc.);
- Nature of transaction (e.g. purchase, leasing, hiring or free consignments, etc);
- Details of procedures undertaken in auditing records and documents, whether held in the computer or not;
- Settlement details with respect to the procedure followed by the importer in paying for his goods;
- Details of any irregularities;
- Any specific action the Customs Administration has instructed the trader to take;
- Disagreement on the conclusions and findings of the audit;
- Auditee's right of appeal
- Sufficient, relevant and reliable evidence to form a sound basis for conclusions contained in the report (i.e. the papers in the file provide the evidence that will be relied upon to contest any appeal by the taxpayer);
- Any national audit standards for reporting;

- Supporting documentation, including notes taken during the audit to be kept safely and securely;
- Papers which are numbered and segregated into the phases of the audit described above;
- All papers/documents, appropriately numbered and segregated into the phases of the audit;
- The reason for selection;
- Reference to the legal authority to audit;
- The audit case plan;
- Taxpayer notification of audit;
- The audit questionnaire;
- The audit tests;
- Details of all communications with the taxpayer;
- Details of information obtained from third parties, e.g. banks;
- Records examined;
- Issues audited;
- Audit methodology adopted (e.g. system-based, specific issues, sampling, indirect methods);
- Reasons for any deviation from the audit plan;
- Findings of audit and support of conclusions;
- Discrepancies discovered and proposed adjustments;
- Taxpayers contentions and resolutions;
- Copy of final report;
- The audit supervisor's approval;
- Record of time spent on audit; and
- Evidence that a copy of the report was sent to all relevant units in the RS.

Evaluation and Follow-up Visit

The Post-Clearance Audit Division may carry out a follow-up desk audit to ensure that any findings and recommendations for changes are carried out by the trader.

The evaluation should measure the:

- Success/effectiveness of the PCA program;
- Additional revenues collected;
- Number of investigation referrals;
- Cost/benefit analysis (i.e. cost of audit versus revenues recouped);
- Audit tests and results are correctly recorded;

- The audit results are fully evaluated;
- The traders rights are fully respected; and
- Anomalies and/or deficiencies in audit procedures are addressed within the agreed implementation timetable.

Quality Assurance Reviews

The RS (Operational Audit and/or Internal Affairs) should selectively monitor and review PCA activities to ensure that the audit:

- Selected the right cases for audit;
- Identified the right issues to audit;
- Was undertaken using the appropriate methodology for the risk identified;
- Collected the right information and made correct judgments;
- Applied the relevant laws to that information; and
- Conducted the audit in line with approved practices.

Auditing Traders' IT Systems

The post-clearance auditors undertaking a field audit may need to carry out an audit of a trader's computer systems used for preparation and submission of single or periodic declarations, purchasing and financial accounting/payments. Systems audit, as the name implies, means looking at the entire trade transaction processing cycle rather than just the individual transactions themselves. It does not rely on a fully visible audit trail and substantive testing of all or a significant number of transactions, as in a manual system. Instead, systems audit uses the inherent properties of computer processing to provide user confidence.

If it can be established that the process itself is reliable and accurate and the controls that govern it are sound and complied with, then safe assumptions can be made regarding the quality of the system's outputs.

The traditional method of checking the accuracy of the "books" on a transaction basis is not only inappropriate in a computer environment, but also probably impossible. Even advanced methods using file interrogation methodology are of little use unless the auditor or audit team understands how the computer and its associated manual procedures combine to produce the required information. This is where a systems audit is most effective.

The principal steps in an IT system's audit are as follows.

Planning

This initial phase is critical to the success and credibility of an audit. It defines the direction, scope, risk areas and ultimate goal against which to measure the effectiveness of the audit. The planning stage will include the establishment of criteria against which a trader's systems should be judged. The system audit should test how the computer system:

- Distinguishes between import, export and domestic consignments;
- Allocates and identify consignments to specific customs regimes;

- Identifies consignments requiring a license or permit;
- Calculates tax and duty liability on consignments;
- Regularly updates commodity code and duty rate files;
- Cross-matches commercial part numbers against commodity codes;
- Uses valuation calculation methods appropriate to the trader's business transactions;
- Issues management reports providing assurance of the completeness of accounting;
- Identifies outstanding, unreported consignments;
- Performs quality cross-matching of commercial transport and accounting information with statistical and accounting information declared to Customs;
- Exercises quality control and management checking procedures to ensure the system is functioning correctly;
- Retains historical data for long enough to comply with national legal requirements; and
- Uses satisfactory back-up procedures in the event of a system breakdown.

Enquiry or Fact-Finding

By interviewing personnel at all levels in the management chain, including the application users and the data processors, the auditor or audit team can discover how the system actually works. The auditor or audit team will also refer to any material such as user guides, system specifications, etc. The controls or lack of them, both internal and operational, can then be identified. Often the way the system works is at variance with how it was designed and implemented and how individuals, especially senior managers, perceive it to be working. The auditor or audit team can also deduce much from the state of system documentation or the lack of it. For example, user manuals may be out of date or incomplete.

Recording/Documenting the System

The auditor or audit team will record the findings either by means of a narrative text or pictorially, by the use of flow diagrams, or both. The diagrams can be at different levels of detail, from a broad overview to actual stages in computer processing. They can cover the document flows before and after computer processing. At this stage, the auditee will normally confirm the auditor or audit team's understanding of the system, before moving on to the next phase.

Evaluation

By reviewing and evaluating the evidence gathered, the auditor or audit team will begin to discover actual or perceived weaknesses in the internal controls. They can then plan tests to measure the effectiveness of the controls and the credibility of the output.

Testing

Testing is carried out to some extent at various stages of the audit, for instance at the fact-gathering stage, by observation and as a result of evaluation. It can be by inspection of records, output reports, etc., or even re-enactment of the processing cycle. Using advanced techniques (i.e. file interrogation software), it is possible to test for unusual combinations of data, which could lead to incorrect processing, as well as for straightforward situations.

Report

The outcome of the audit will usually be a report to senior management that will make recommendations as to how identified weaknesses can be eliminated or controls tailored to be more effective. Controls can even be discarded if they are seen to be irrelevant in a particular situation.

Conclusion

Once a system has been recorded and evaluated and any amendments to improve control have been implemented, it can be expected to perform reliably until the next significant change is undertaken. However, periodic audits need to be carried out to confirm that nothing has changed and that the controls that have been built in to the system continue to be administered and adhered to. The use of audit packs (a set of pre-programmed audit tests) can be used to automate this process.

Recommendations: The RS should implement international best practices for conducting customs post-clearance desk, field and IT-based audits. The PCA cycle should include:

- Developing an Audit Plan
- Identifying and Selecting Potential Traders/Operators to Audit
- Preparing for Audit
- An Initial Letter to the Auditee
- An Initial Meeting with the Auditee
- Audit Coordination and Communication
- Formalizing the Auditee Contacts
- Undertaking a Pre-Audit Survey
- Encouraging the Auditee to Undertake a Self-Assessment
- Having the Auditee complete a Questionnaire
- Preparing an Auditee Company Profile
- Preparing an Auditee Transaction Profile
- Conducting the Post-Clearance Desk and/or Field Audit
- Undertaking an Internal Auditee Review
- Closing the PCA
- Having an Exit Conference/Meeting with the Auditee
- Preparing an Audit Report/File
- Undertaking a post-audit Evaluation/Follow-up

Technical assistance and training is required to support effective implementation of PCA's control.

STRATEGY FORWARD

Implementation of risk-based PCA controls should be an integral part of Georgia's customs reform and modernization program. Its implementation will allow the RS to obtain a more appropriate balance between its on-going trade facilitation agenda and the need to strengthen its customs controls. Implementation will support Georgian Customs as it continues to expedite the release of goods in an effort to encourage an attractive foreign investment climate. It will afford an opportunity to keep cargo dwell times and related trade transaction costs to an absolute minimum, while also allowing Georgian Customs to more effectively tackle commercial fraud, especially under-valuation of imports and associated revenue losses.

Compliance verification through PCA is a prerequisite to implementing an AEO regime. AEO regimes will strengthen the international supply chain and rewards those firms that meet the strict security requirements confirmed through AEO security audits. Firms granted AEO status by Georgian Customs will receive expedited clearance of their exports as they enter those foreign markets that mutually recognize the AEO status granted by Georgia Customs.

To implement an effective PCA program in Georgia will require a significant investment in both material and human resources. The RS will need to:

- Display significant commitment and ownership to implement risk-based PCA;
- Strengthen the current legal framework so that it fully supports PCA's. Estimated short-term external technical assistance to analyze deficiencies and draft amendments in the Tax Code and to draft a PCA bylaws is two months;
- Draft SOP manuals for both risk management and PCA. These SOP manuals should have a structure, content and glossary of customs terms which will be consistent with the comprehensive set of SOP manuals to be prepared as part of the customs reform and modernization program. These manuals should form the basis for developing technical customs training courses related to risk-based PCA's. The manuals will need to be drafted, discussed in detail with RS senior management, and signed-off by the Head of the RS before technical PCA training can commence. Estimated short-term external technical assistance to draft risk management and customs PCA control SOP manuals is three months;
- Redress significant weaknesses in human resource management and development in both the Risk Management and Post-Clearance Audit Divisions. This will require:
 - Bringing the organizational structure for the Risk Management Division and Customs Post-Clearance Audit Division in-line with international best practice
 - The Risk Management Division should report directly to the Head of the RS; and
 - In the medium-term, the Customs Post-clearance Audit Division should move out of the RS headquarters and back to regional field operations;
 - Giving Customs intern auditors additional foundational technical customs training courses especially in customs valuation, H.S classification, and origin/preferential trade agreements. It is important that intern auditors have a comprehensive understanding of these key areas before they receive specialized technical training courses in post-clearance auditing techniques. It is estimated that delivery of the H.S. classification, customs valuation and

trade agreement courses would take approximately six weeks (two weeks per course). Once the foundation training is completed, it is envisioned that the PCA training would be spread over three courses, each course of two-week duration. The first course would cover customs post-clearance desk audits. A second course would cover customs post-clearance field audits. A third course would cover auditing of trader IT systems. These courses would be delivered over a six-month period as auditors obtain experience in conducting desk audits before attempting field audits and subsequently trader IT audits. Estimated short-term external technical assistance to prepare and deliver this foundation training is three months, i.e. eight weeks to prepare course materials, followed by another three weeks to deliver train the trainer material to the two designated Georgian trainers;

- Providing all staff posted to the Post-Clearance Audit Division with additional ASYCUDA technical user training and a password to allow them access to the ASYCUDA database. This training should be provided by qualified staff in the IT Division conversant with these aspects of the ASYCUDA World. This ASYCUDA training would allow PCA staff to efficiently and effectively retrieve declaration data and produce statistical reports, in order to analyze and select high-risk traders and particular high-risk transactions to audit;
- Increasing the number of auditors in the Customs Post-Clearance Audit Division by adding 15 additional auditors to supplement the existing staff of 10. Ideally, customs officers being transferred to PCA will have business, accounting or auditing backgrounds. This selection/transfer of the initial 15 additional auditors will need to coincide with the completion of the SOP manuals and training materials. A second intake of 25 customs interns would need to occur after the first group of 25 post-clearance auditors have gained experience and proven their ability to efficiently and effectively conduct both desk audits and field audits. The second batch of interns would be needed approximately six months after the first group have received their PCA training and had an opportunity to apply the new desk audit and field audit techniques. At this time, some of these auditors could be redeployed to the various regional offices.
- Providing additional office space and IT equipment in the short-term at the RS headquarters for these additional auditors until both batches of auditors (i.e. 50 in total) have received training and gained practical experience in undertaking desk and field audits and are ready to be relocated back to the regions. In the medium-term, office space and IT equipment should be provided in the regional offices for post-clearance auditors;
- Providing a classroom at the RS headquarters for two sessions of 25 auditors, for delivery of foundation customs technical training, followed by risk management and post-clearance desk and field audit training;
- Assigning two experienced, full time Georgian trainers to receive training from EPI experts. Once trained, these trainers would then deliver the customs foundation training courses in valuation, tariff classification and origin, then the specialized training courses in risk management and PCA techniques in the Georgian language;
- Drafting job descriptions for managers and officers working in both the Risk Management Division and the Post-Clearance Audit Division;

- Reviewing auditor basic remuneration and bonus systems to improve the basic remuneration and implement a performance-based incentive scheme for auditors. The RS needs to ensure that Customs Post-Clearance Auditors receive an adequate salary comparable to what they would earn in the private sector as an auditor. Consideration should also be given to introducing performance-based bonuses or other motivational incentives for auditors. In some customs services, these incentives may be related to additional revenue assessed/collected from the conduct of an audit;
 - Designing and implement an anti-corruption strategy for post-clearance auditors. Estimated short term technical assistance is 1 month;
 - Giving PCA staff direct access to the current customs valuation reference price database so that they may compare declared customs import values of goods with those values/reference prices maintained in the database. Currently, only particular staff in the Expertise Unit located at the Gezi have access to the reference price database. Without access to the reference price database, there is no guarantee of consistency between how the Expertise Unit would check the declared customs value of goods and how the PCA would check the declared value of “like or similar” goods during the PCA;
 - Developing a tariff classification rulings database and making it available to PCA’s (as well as Gezi staff) so that H.S. explanatory notes and all international and national tariff classification rulings are available on-line to staff (and stakeholders). This would ensure that there is greater transparency, consistency and less discretion in how goods are classified by Georgian Customs whether that be pre-release control or on a PCA basis;
 - Providing laptops to those auditors performing field audits; and
 - Providing vehicles or vehicle allowances for field auditors visiting traders’ premises;
- Prepare tender/procure Risk Management Software Suite to support risk management and PCA’s. It is recommended that at least one risk management software vendor be invited to come to Georgia and give a detailed presentation/demonstration of commercially available risk management software that can complement the ASYCUDA selectivity software. This could perhaps be organized during the risk management life cycle training course. Estimated short-term assistance to prepare risk management tender is one month;
 - Provide hands-on technical assistance to the Risk Management Division in utilizing the risk management life cycle process. Estimated short-term external technical assistance to providing hands on assistance to the Risk Management Unit and Post-Clearance Audit Division in developing risk profiles and selectivity is two months;
 - Provide hands-on technical assistance to the Post-Clearance Audit Division in conducting desk audits and commencing field audits of Gold List firms. Estimated short term technical assistance is three months; and
 - Strengthen the risk management channeling in ASYCUDA to bring it more in line with international best practice.

In the short-term, Customs should significantly improve the risk management criteria for Blue Channel (i.e. move away from random selection of e-filed declarations to selective desk

audits based on a comprehensive Risk Management Cycle). Only declarations from specific sectors and traders deemed high risk by the Post-Clearance Audit Division would go through the Blue Channel. In the medium-term, the Post-Clearance Audit Division should commence desk audits on the highest-risk Gold List firms. Within a year, as technical training is given, additional auditors are assigned, and capacity is built within the Post-Clearance Audit Unit, field audits of Gold List firms would commence. Selective auditing of Gold List traders would confirm their compliance and eligibility to continue to receive the privileges of the program.

In the medium-term, Georgian Customs should:

- Bring its import declaration risk channeling in-line with international best practice (i.e. Red, Yellow and Green), possibly adding an Orange Channel for goods having phyto-sanitary and other border agency requirements. A Yellow Channel should be implemented at all customs clearance offices. The Monitoring and Expertise Units should be combined with additional staff assigned to create a Commodity Specialist Unit. This unit would be organized by different chapters of the tariff where there are perceived risks in tariff classification and valuation (e.g. auto spare parts, foodstuffs, building supplies, garments, etc.). Organizing the declaration verification function by commodity specialization is consistent with international best practice and allows officers to more easily understand particular trade sectors, commodities, trends in pricing, etc. Once this unit is fully operational, it would be possible to direct more Yellow Channel declarations for verification prior to release. Consideration should be given to setting a maximum time-limit in ASYCUDA for Yellow Channel declarations to turn Green (e.g. four-five hours). If Customs has not changed the Yellow Channel to Green within this period, it would automatically do so unless Customs had turned the declaration Red. This feature currently exists in ASYCUDA World but is not utilized. It would allow Customs to exercise greater control at the time of release, while guaranteeing reasonable release times for traders;
- Change the proportion of declarations processed through each channel in order to achieve a more realistic balance between facilitation and control. This will require putting in place a more effective risk management process. It will also require redeploying customs officers from largely administrative data entry tasks to higher value compliance verification functions including declaration, verification, physical inspection of cargo, and PCA of high-risk traders' books, records and systems. Risk channeling rates should be brought in-line with international best practice, for example:

– Red	10-15%;
– Yellow	20-40%;
– Green	45-70%;
- Eliminate the Blue Channel, once the Post-Clearance Audit Division has been reformed as proposed in this report. The concept of randomly selecting at the time of release individual, transaction-by-transaction import declarations for PCA should be replaced with a post-release risk-based selection of high-risk traders and specific transactions which the Post-Clearance Audit Division would undertake a initial desk audit of, and if necessary, a field audit of the trader's books, records and systems;
- Commence customs undertaking selective cargo inspections of Gold List traders' consignments, performing such inspections at the trader's premises when the goods are un-stuffed to ensure that release times are not affected. This would allow

Customs to detect any enclosures and overages that are unlikely to be detected through PCA's. Data mining should be commenced to identify high-risk sectors, firms and transactions on which they should undertake a desk audit. The direction of such data mining will arise following implementation of an effective risk management cycle;

- Have Customs at Gezi's/customs clearance offices take a more proactive stance in challenging goods that appear to be undervalued. Consideration should be given to providing "operators" access to the valuation reference price database. As more declarations are channeled Yellow, requiring detailed document verification, it is important that more specialization in back-office customs officers staff be built. Consideration should be given to setting up a Commodity Specialist Unit (i.e. combining Monitoring and Expertise Units into a Commodity Specialist Unit).
 - This unit would be organized by high-risk commodity groupings to allow officers to better understand and follow trade issues within specific sectors (e.g. auto spare parts, equipment, chemicals, clothing/garments, foodstuffs, motor vehicles, etc.).
 - Declarations channeled Yellow could be routed to the appropriate specialized officers and quick turn-around of declarations could be encouraged with the implementation of an automatic release (i.e. automatic change from Yellow to Green within a prescribed time limit of, for example, four hours if Customs has not already made a status change in the system).
 - This would guarantee that goods release is not negatively impacted by strengthening of the document verification function prior to release of goods. Estimated short-term, hands-on technical assistance to strengthen the Yellow Channel risk processing stream/detailed document verification, including setting up the Commodity Specialist Unit at the Gezi's and providing technical training to Commodity Specialist officers, is three months;
- Encourage traders to e-file their declarations by increasing fees charged for this data entry function and offering direct trader input terminals at checkpoints and Gezi's. Specific objectives should be set to reduce data keying by Customs over the next 18 months (e.g. 75% of total import declarations e-filed by end of 2012, 95% e-filed by end of 2013);
- Extend the WCO CEN database to the Risk Management Division and Post-Clearance Audit Division;
- Prepare a realistic annual audit plan, which will be critical to the success of the PCA program. The annual audit plan will ensure optimum use of limited audit resources (i.e. ensure resources are allocated based on risk to achieve maximum results). Estimated short-term technical assistance is one month;
- Examine and if necessary amend its current mutual administrative assistance agreements to ensure they fully support PCA requirements;
- Implement the WCO recommended Risk Management Life Cycle to support effective implementation of risk-based PCA controls. This cycle should consist of the following formal steps:
 - Establish the risk management context;
 - Identify the risks;

- Analyzing the Risks
 - Evaluating the Risks;
 - Addressing/Treating the Risks; and
 - Monitoring and review of the process through compliance measurement;
- Implement international best practices for conducting post-clearance desk, field and IT based audits. The PCA process should include:
 - Developing an audit plan;
 - Identifying and selecting potential traders/operators to audit;
 - Preparing for audit;
 - An initial letter to the auditee;
 - An initial meeting with the auditee;
 - Audit coordination and communication;
 - Formalizing the auditee contacts;
 - Undertaking a pre-audit survey;
 - Encouraging the auditee to undertake a self-assessment;
 - Having the auditee complete a questionnaire;
 - Preparing an auditee company profile;
 - Preparing an auditee transaction profile;
 - Conducting the post-clearance desk and/or field audit;
 - Undertaking an internal auditee review;
 - Closing the PCA;
 - Having an exit conference/meeting with the auditee;
 - Preparing an audit report/file; and
 - Undertaking a post-audit evaluation/follow-up.

C. ADDITIONAL INFORMATION

DEFINITIONS

Auditee: Person or companies directly or indirectly involved in an international trade transaction including importers, exporters, customs brokers, freight forwarders, shippers, carriers.

Audit-based control: Measures by which Customs satisfy themselves as to the accuracy and authenticity of declarations through the examination of the relevant books, records, business systems and commercial data held by persons concerned.

Compliance management: The holistic recognition of the level of conformity with laws, regulations, and obligations. Used as a tool for granting privileges and as an input to risk management.

Customs offense: Any breach or attempted breach of customs law.

Document: Any physical or electronic medium designed to carry and actually carrying a record of data entries.

Mutual administrative assistance: Actions of a customs administration on behalf of or in collaboration with another customs administration for the proper application of customs laws and for the prevention, investigation and repression of customs offenses.

Post-clearance audit (PCA): The process of verifying the compliance of a business with customs legislation, through an examination of accounts and other records of that business.

Risk: The potential for non-compliance with customs laws.

Risk analysis: Systematic use of available information to determine how often defined risks may occur and the magnitude of their likely consequences.

Risk areas: Those customs procedures and categories of international traffic that present a risk.

Risk assessment: The systematic determination of risk management priorities by evaluating and comparing the level of risk against predetermined standards, target risk levels or other criteria.

Risk indicators: Specific criteria which, when taken together, serve as a practical tool to select and target movements for the potential for non-compliance with customs law.

Risk management: The systematic application of management procedures and practices that provides Customs with the necessary information to address movements or consignments that present a risk.

Risk profile: A predetermined combination of risk indicators, based on information that has been gathered, analyzed and categorized.

Selectivity: The application of risk profiles to declarations, operations, individuals, or transactions.

Systems-based control: Measures to ensure that a trader's system contains the checks and controls necessary for compliance with customs laws.

Targeting: The pre-identification of operations declarations, operations, individuals, or transactions to be verified based on information or intelligence, visible external criteria, or control plans.

**USAID Economic Prosperity Initiative (EPI)
6 Samgebro St.**

Tbilisi, Georgia

Phone: +995 32 43 89 24/25/26

Fax: +995 32 43 89 27